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No. 91-1677-CFX
Status: GRANTED

Title: Commissioner of Internal Revenue, Petitioner
v.
Keystone Consolidated Industries, Inc.

Docketed:
April 16, 1992

Court: United States Court of Appeals for the Fifth Circuit

Counsel for petitioner: Solicitor General

Counsel for respondent: Wexler,Raymond P.

Entry	Date	Note	Proceedings and Orders
1	Apr 16 1992	G	Petition for writ of certiorari filed.
2	May 14 1992		Brief amicus curiae of Pension Benefit Guaranty Corp. filed.
3	May 20 1992		DISTRIBUTED. June 5, 1992
4	May 22 1992	X	Brief of respondent Keystone Consolidated Industries in opposition filed.
5	Jun 1 1992	X	Reply brief of petitioner filed.
6	Jul 8 1992	N	Motion of the Solicitor General to renew consideration of the petition for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit filed.
7	Jul 23 1992		Brief of respondent in reply to petitioner's motion to renew consideration of petition for a writ of certiorari filed.
8	Jul 29 1992		REDISTRIBUTED. September 28, 1992
9	Oct 5 1992		Petition GRANTED.
			**
10	Oct 13 1992	G	Motion of the Solicitor General to dispense with printing the joint appendix filed.
11	Oct 19 1992		Motion of the Solicitor General to dispense with printing the joint appendix GRANTED.
12	Oct 22 1992		Record filed.
		*	Partial proceedings United States Court of Appeals for the Fifth Circuit.
13	Oct 23 1992		Record filed.
		*	Original proceedings United States Tax Court.
14	Nov 19 1992		Brief amicus curiae of Pension Benefit Guaranty Corp. filed.
15	Nov 19 1992		Brief of petitioner filed.
17	Dec 22 1992		Brief of respondent Keystone Consolidated Industries in opposition filed.
16	Dec 28 1992		SET FOR ARGUMENT MONDAY, FEBRUARY 22, 1993.(1st Case).
18	Jan 7 1993		CIRCULATED.
19	Jan 27 1993	X	Reply brief of petitioner filed.
20	Feb 22 1993		ARGUED.

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91-1677

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No.

In the Supreme Court of the United States

OCTOBER TERM, 1991

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTION PRESENTED

Whether the contribution of property to a defined benefit pension plan by the plan's sponsoring employer, in satisfaction of the employer's funding obligation, constitutes a prohibited "sale or exchange" of the property under 26 U.S.C. 4975.

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In the Supreme Court of the United States

OCTOBER TERM, 1991

No.

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-9a) is reported at 951 F.2d 76. The memorandum opinion of the United States Tax Court (App., *infra*, 10a-17a) is reported at 60 T.C.M. (CCH) 1423.

JURISDICTION

The judgment of the court of appeals was entered on January 17, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

Sections 404, 412, 4941, 4971, and 4975 of the Internal Revenue Code (26 U.S.C.) and Sections 302 and 406 of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1082 and 1106, are set forth in pertinent part in the appendix. App., *infra*, 45a-52a.

STATEMENT

1. During its taxable years ending June 30, 1983, through June 30, 1988, respondent Keystone Consolidated Industries, Inc., maintained several tax-qualified defined benefit pension plans.[1] The plans were subject to the funding requirements of Section 302 of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1082. See also 26 U.S.C. 412. Respondent funded the pension plans through contributions to the Keystone Consolidated Master Pension Trust. App., *infra*, 2a.

On March 8, 1983, respondent contributed five truck terminals with a fair market value of $9,655,454 to the Pension Trust. Respondent credited the fair market value of the truck terminals against its statutory funding obligations to its employees' defined benefit pension plans for its taxable years ending June 30, 1982, and June 30, 1983. App., *infra*, 11a. In addition, on March 13, 1984, respondent contributed to the Pension Trust real property in Key West, Florida, having a fair market value of $5,336,751. Respondent credited the fair market value of the Key West property against its statutory funding obligations to the Pension Trust for the taxable year ending June 30, 1984. *Id.* at 11a-12a.

Respondent claimed deductions on its federal income tax returns under 26 U.S.C. 404 in the amount of the fair market value of the five truck terminals and the Key West property. Respondent also reported the difference between its basis in those properties and the fair market values of the properties as capital gain, *i.e.*, as gain from the "sale or exchange" of capital assets. App., *infra*, 12a; see 26 U.S.C. 1222.

Section 4975 of the Internal Revenue Code imposes a two-tier excise tax on specified "prohibited transactions" between a pension plan and a "disqualified person," which includes the employer of the employees covered by the plan. 26 U.S.C. 4975(e)(2)(C).[2] Among the transactions prohibited by Section 4975 is the "direct or indirect * * * sale or exchange * * *

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[1] A defined benefit plan is a plan under which retirees receive a fixed amount per month, which is typically based on factors such as the retiree's prior salary and years of service. Such plans differ from defined contribution plans, under which employers typically contribute a percentage of their payroll or profits to a plan, which then allocates the contributions to individual accounts, and retirees are entitled to the amount in their individual accounts upon retirement. See 29 U.S.C. 1002(34) and (35). If a plan qualifies for favorable tax treatment, the employer may immediately deduct its contributions to the plan, but the plan participants are not taxed until they receive distributions from the plan. See 26 U.S.C. 402(a)(1), 404(a)(1)(A).

[2] The first tier of the excise tax is five percent of the "amount involved," 26 U.S.C. 4975(a), while the second tier is 100 percent of the "amount involved," 26 U.S.C. 4975(b). The "amount involved" is the greater of the fair market value of the property as given or received. 26 U.S.C. 4975(f)(4). Unlike the first tier tax, the second tier tax ordinarily may be avoided by timely correction of the prohibited transaction upon completion of the litigation concerning the taxpayer's liability for that tax. See 26 U.S.C. 4961(a), 4963(b) and (e), 6213(a), 7481(a). For example, in the case of a sale or exchange, the second tier tax may be avoided by correcting the transaction.

of any property between a plan and a disqualified person." 26 U.S.C. 4975(c)(1)(A). The Commissioner of Internal Revenue determined that respondent's transfers to the Pension Trust of the five truck terminals and the Key West property constituted "sale[s] or exchange[s]" of those properties within the meaning of Section 4975(c)(1)(A). Accordingly, the Commissioner determined that the transfers of the properties to the Pension Trust were prohibited transactions subject to excise tax under Section 4975.[3] Respondent filed a petition in the Tax Court for a redetermination of its liability for the excise taxes.

2. While respondent's case was pending before the Tax Court, the Tax Court rendered its decision in *Wood* v. *Commissioner*, 95 T.C. 364 (1990), rev'd, No. 91-1717 (4th Cir. Jan. 31, 1992); App., *infra*, 32a-44a, which presented the same issue as this case. In *Wood*, the taxpayer contributed three third-party promissory notes to his defined benefit pension plan in satisfaction of his statutory funding obligation.[4]

[3] The Commissioner determined deficiencies in respondent's first tier excise liability of $749,610 for its taxable year ending June 30, 1984, and of $482,773 for each of the taxable years ending June 30, 1983, and June 30, 1985, through June 30, 1988. The Commissioner also determined a deficiency in respondent's second tier excise tax liability for its taxable year ending June 30, 1988, in the amount of $9,655,454. App., *infra*, 12a.

[4] The taxpayer in *Wood* overstated the value of the notes, claiming a deduction for their face amounts, totaling $114,000, rather than for their fair market value of $94,430. 95 T.C. at 366. Although the taxpayer did not report any gain on the transfer of the notes to the plan, the parties stipulated in the Tax Court that the taxpayer was required to report the difference between the face amounts of the notes and the cost of the

In *Wood*, as in this case, the Commissioner determined that the transfer of property in satisfaction of the taxpayer's statutory funding obligation was a "sale or exchange" of the property within the meaning of Section 4975(c)(1)(A).

In *Wood*, the Tax Court rejected the Commissioner's position. The Tax Court acknowledged that the taxpayer's "transfer of the notes to the plan is a sale or exchange for purposes of recognition of income to him." App., *infra*, 42a. It further acknowledged that the case "demonstrate[d] potential for abuse" because the taxpayer "overstated the value of the property contributed to the plan." *Id.* at 38a. Furthermore, the Tax Court recognized that the Department of Labor, which has authority to interpret the prohibited transaction provisions—including Section 406 of ERISA, 29 U.S.C. 1106, which is parallel to Section 4975 and proscribes prohibited transactions between employee benefit plans and their fiduciaries—had concluded that a transfer of property to a defined benefit pension plan in satisfaction of an employer's funding obligation is a prohibited "sale or exchange" under Section 406(a)(1)(A). App., *infra*, 44a.

The Tax Court declined to give "sale or exchange" its usual meaning primarily because it concluded that the "detailed definition[] of sale or exchange" set out in Section 4975(f)(3) "should be applied in lieu of general definitions found in other areas of the tax law." App., *infra*, 42a. Section 4975(f)(3) provides that "[a] transfer [of] real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mort-

notes as capital gain, *i.e.*, as gain from the sale or exchange of a capital asset. 95 T.C. at 371-372.

gage or similar lien." Thus, the Tax Court disagreed with the Commissioner's submission that Section 4975 (f)(3) expands the usual definition of "sale or exchange" to include all transfers of encumbered property to a plan, even those transfers that are entirely voluntary.[5] In short, the Commissioner had concluded that for purposes of Section 4975 "sale or exchange" includes not only transfers made to satisfy obligations, as is generally the case, but also any transfer of encumbered property, even if such a transfer would not normally constitute a "sale or exchange" with the plan. Contrary to the Commissioner's submission, the Tax Court held that Section 4975(f)(3) restricts the scope of "sale or exchange" for purposes of the prohibited transaction provision so that a transfer of unencumbered property to a pension plan in satisfaction of a funding obligation is not a "sale or exchange."

3. Shortly after the issuance of its opinion in *Wood*, the Tax Court issued a memorandum opinion in this case finding in favor of the taxpayer, essentially for the reasons stated in its prior decision. App., *infra*, 10a-17a.

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[5] A voluntary transfer would include a transfer to a defined contribution plan that was not required by the terms of the plan. That is, many defined contribution plans provide that the sponsoring employer must contribute a certain amount to the plan, and further provide that the sponsor may make additional contributions. An additional contribution to a plan would not be a "sale or exchange" with the plan under the normal meaning of that phrase since it would not extinguish any obligation, and therefore such a contribution would not be prohibited by Section 4975(c)(1)(A). But if such a contribution consisted of encumbered property, it would be "treated as a sale or exchange," and hence be prohibited, under Section 4975(f)(3).

4. The Commissioner appealed the Tax Court's decisions in *Wood* and in this case to the Fourth Circuit and Fifth Circuit, respectively. In this case, the Fifth Circuit affirmed the decision of the Tax Court. The court of appeals reasoned that Section 4975(f)(3) "states that a transfer of property encumbered by a mortgage or lien *shall be treated* as a sale or exchange, implying that unless it is encumbered by a mortgage or lien, a transfer of property is not to be treated as if it were a sale or exchange." App., *infra*, 5a. With respect to the Commissioner's argument that Section 4975(f)(3) expands the definition of "sale or exchange" to include voluntary transfers of encumbered property, the court responded that, in its view, there is "no basis * * * anywhere in the Code" for distinguishing transfers of property in satisfaction of funding obligations from voluntary transfers of property to pension plans. App., *infra*, 6a.

The court of appeals added that, in its view, "[t]he potential for abuse, that is, satisfaction of minimum mandatory obligations with property with inflated values, would be the same regardless of whether the transfer was involuntary." App., *infra*, 6a. The court also stated that the potential for abuse in transfers of property in satisfaction of funding obligations is "already restrained" by the excise tax on accumulated funding deficiencies set out in 26 U.S.C. 4971. App., *infra*, 8a. Moreover, it is "irrelevant," the court stated, that transfers of property in satisfaction of obligations are treated as sales or exchanges of property for income tax purposes, because Section 4975 "was not enacted to measure economic income." App., *infra*, 7a. Finally, the court found that the contrary interpretations of the Department of Labor and of the Internal Revenue Service were entitled to no deference because those interpretations had been

set forth in advisory opinions and Revenue Rulings, respectively, and not in published regulations. *Id.* at 7a-8a.

5. In *Wood*, the Fourth Circuit "found itself in disagreement with the reasoning of the Fifth Circuit's decision in *Keystone Consol. Indus.*" App., *infra*, 28a. It instead gave "considerable weight" to the IRS's conclusion that "the transfer of property in satisfaction of a sponsor's statutory funding obligation" constitutes a "sale or exchange" of the property. *Id.* at 28a-29a. The Fourth Circuit also was "persuaded by the interpretation given to a parallel ERISA provision by the Department of Labor" in interpreting 29 U.S.C. 1106 to prohibit an employer from transferring "property in satisfaction of a sponsor's funding obligation." App., *infra*, 29a.

Contrary to the Fifth Circuit, the Fourth Circuit did "not view § 4975(f)(3) as a special rule limiting the applicability of the excise tax to contributions of encumbered property." App., *infra*, 27a. Rather, like the Commissioner, the Fourth Circuit concluded that Section 4975(f)(3) "reveals the intent of Congress to expand the definition of 'sale or exchange' as generally understood to include *all transfers* to a plan of *encumbered* property, whether or not in discharge of a debt, because transfers of encumbered property present a particularly significant potential for abuse." App., *infra*, 27a-28a; see also H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 308 (1974) (Section 4975 (f)(3) "prevents circumvention of the prohibition on sale by mortgaging the property before transfer to the plan").[6] Thus, the Fourth Circuit held that, for purposes of the prohibited transaction provision, "sale or exchange" includes "the transfer of property in satisfaction of indebtedness," in line with the longstanding interpretation of that phrase. App., *infra*, 28a. "While the transfer to a plan of unencumbered property becomes a sale or exchange only if the transfer satisfies a funding obligation," the court continued, under Section 4975(f)(3) "when encumbered property is involved *all* transfers to the plan are prohibited, regardless of whether they are contributed in satisfaction of a pre-existing debt." App., *infra*, 29a-30a.

[6] With respect to the potential for abuse caused by transfers of unencumbered property to a pension plan in satisfaction of a debt, the Fourth Circuit in *Wood* noted that the prohibition against such transfers "is intended to avoid the potential for overvaluations of property to the detriment of the plan, precisely as occurred * * * when Wood purported to discharge a $114,000 obligation with third-party promissory notes having a value of only $94,430." App., *infra*, 25a.

REASONS FOR GRANTING THE PETITION

Section 4975(c)(1) of the Internal Revenue Code prohibits "any direct or indirect—(A) sale or exchange" between a plan and a disqualified person, such as respondent. The court of appeals' holding that respondent's transfer of property to the Pension Trust in satisfaction of its funding obligation was not a sale or exchange of the property is contrary to the language of the statute. In addition, the court's holding is in direct conflict with the decision of the Fourth Circuit in *Wood* v. *Commissioner*, No. 91-1717 (Jan. 31, 1992). The issue is of substantial administrative importance since many employers desire to transfer property to pension plans to satisfy their funding obligations, rather than paying their obligations in cash.

1. It is well established that the transfer of property in satisfaction of an obligation, as occurred in

this case when respondent transferred the truck terminals and the Key West property to the Pension Trust to satisfy its statutory funding obligations, generally constitutes a "sale or exchange" of the property. See, *e.g.*, *Helvering* v. *Hammel*, 311 U.S. 504 (1941); *Lakeside Irr. Co.* v. *Commissioner*, 128 F.2d 418, 419 (5th Cir.), cert. denied, 317 U.S. 666 (1942); *Burger-Phillips Co.* v. *Commissioner*, 126 F.2d 934, 935 (5th Cir. 1942); *Pender* v. *Commissioner*, 110 F.2d 477, 478 (4th Cir.), cert. denied, 310 U.S. 650 (1940); *Laport* v. *Commissioner*, 671 F.2d 1028, 1033 (7th Cir. 1982); *Stamler* v. *Commissioner*, 145 F.2d 37, 39 (3d Cir. 1944); *Larus* v. *Commissioner*, 123 F.2d 254, 255 (2d Cir. 1941). Similarly, the courts have treated transfers of property to satisfy a bequest that was stated in dollar terms, a transaction not unlike a transfer of property in satisfaction of a funding obligation, as a "sale or exchange" of the property transferred. See *Kenan* v. *Commissioner*, 114 F.2d 217, 219-220 (2d Cir. 1940); *Brinckerhoff* v. *Commissioner*, 8 T.C. 1045, 1049 (1947), aff'd, 168 F.2d 436 (2d Cir. 1948).

The administrative interpretations of the Department of Labor regarding the transfer of property to a plan in satisfaction of the employer's statutory minimum funding obligation are consistent with the many decisions holding that the transfer of property to satisfy an obligation is a "sale or exchange" of the property. Section 4975 originated in Title II of ERISA (which amended various provisions of the Internal Revenue Code relating to pension plans), and a parallel and identical (as relevant here) provision setting forth "prohibited transactions" was enacted in Title I of ERISA ("protection of employee

benefit rights"), which is administered by the Department of Labor. That provision, Section 406 of ERISA, 29 U.S.C. 1106, prohibits a fiduciary of a pension plan from engaging in a transaction that he knows or should know constitutes a direct or indirect "sale or exchange" of property between the plan and a party in interest. Congress stated that, "[t]o the maximum extent possible, the prohibited transaction rules are identical in the labor and tax provisions, so they will apply in the same manner to the same transaction." H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 295-296 (1974). Accordingly, the Department of Labor's interpretation of Section 406 of ERISA is instructive with respect to the proper interpretation of Section 4975 of the Internal Revenue Code.[7]

The Department of Labor has concluded that the transfer of property in satisfaction of a funding obligation is a "sale or exchange" under Section 406 of ERISA. In DOL Advisory Opinion 81-69A (July 28, 1981), the Department ruled that a sponsoring employer's contribution of unencumbered property to a pension plan was a prohibited sale or exchange. The ruling concluded that such a transaction "constitutes a discharge by the Employer of its legal obligation to make the contribution for that year. In effect, the Plan is exchanging its legal right to payment of the contribution for property other than cash." Accord DOL Advisory Opinion 90-05A (Mar. 29, 1990).

The IRS has accorded the same meaning to the phrase "sale or exchange" in interpreting Section

[7] In fact, the Department of Labor has primary authority to construe both 29 U.S.C. 1106 and 26 U.S.C. 4975. See Reorg. Plan No. 4 of 1978, § 102, 92 Stat. 3790.

4941 of the Internal Revenue Code, upon which Section 4975 was modeled. S. Rep. No. 383, 93d Cong., 1st Sess. 32 (1973); H.R. Conf. Rep. No. 1280, *supra*, at 306. Section 4941(d)(1)(A) defines the term "self-dealing" to include the "sale or exchange" of property between a private foundation and a disqualified person. If a transaction constitutes "self-dealing" under Section 4941, an excise tax is imposed, as under Section 4975, whether or not the particular transaction, in fact, met an "arm's-length" standard of dealing between the parties. In Rev. Rul. 81-40, 1981-1 C.B. 508, the Internal Revenue Service ruled that if a disqualified person attempted to correct an act of self-dealing (there, the borrowing of money from a private foundation) by transferring real estate to the private foundation in cancellation of the indebtedness, the transfer of the property in satisfaction of the indebtedness would constitute a second act of self-dealing, because the transfer of the property in satisfaction of the indebtedness would constitute a sale of property within the meaning of Section 4941. Accord, Rev. Rul. 77-379, 1977-2 C.B. 387; see Treas. Reg. 1.415-6(b)(4).

2. In *Wood* v. *Commissioner*, *supra*, the Fourth Circuit agreed with the Commissioner that the transfer of property in satisfaction of a funding obligation is a prohibited "sale or exchange" under Section 4975. Moreover, in that case the Fourth Circuit explicitly stated that it found itself "in disagreement with the reasoning of the Fifth Circuit's decision" in this case. App., *infra*, 28a. Thus, there is a square conflict on the question presented in this case.[8]

[8] The Fourth and Fifth Circuits also disagreed on a subsidiary issue, whether deference should be given to the opinions of the IRS and the Department of Labor. The Fourth

The Fourth Circuit reached the correct result. Section 4975(c)(1)(A) prohibits any direct or indirect sale or exchange between a plan and a sponsoring employer. A transfer of property in fulfillment of an obligation is plainly a sale or exchange with the plan. Such a transaction is no different, in substance, from one in which the sponsor of a plan makes a payment in cash and the plan simultaneously uses the funds to purchase the property from the sponsor. The transfer of property in satisfaction of an obligation simply collapses those two steps into a single transaction, but does not change its essential character as a sale or exchange of the property trans-

Circuit stated that it was "persuaded" by the Department of Labor's interpretation of ERISA and added that it gave "considerable weight" to the IRS's views. App., *infra*, 28a-29a. In this case, in contrast, the court of appeals declined to accord any significance to the advisory opinions of the Department of Labor, noting that such opinions were binding only on the parties. *Id.* at 7a-8a. However, in a more recent case the Fifth Circuit stated that "DOL opinions 'constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance.'" *Md. Physicians & Associates, Inc.* v. *State Board of Insurance*, No. 91-1469 (5th Cir. Apr. 1, 1992), slip op. 3519 n.9, quoting *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944); see also *Massachussetts* v. *Morash*, 490 U.S. 107, 118 & n.14 (1989); *Fraver* v. *North Carolina Farm Bureau Mutual Insurance Co.*, 801 F.2d 675, 677-678 (4th Cir. 1986); *Shea* v. *Wells Fargo Armored Service Corp.*, 810 F.2d 372, 376 (2d Cir. 1987). In addition, the court of appeals concluded that the IRS's views were entitled to no deference because the Commissioner had not asserted the same arguments in prior litigation. App., *infra*, 8a. But the Commissioner's longstanding interpretation of the statutory language upon which Section 4975 was modeled was fixed, and has remained constant, since the promulgation of Rev. Rul. 77-379, *supra*, and Rev. Rul. 81-40, *supra*.

ferred. Cf. *Pender* v. *Commissioner*, 110 F.2d at 478; *Burger-Phillips Co.* v. *Commissioner*, 126 F.2d at 936; *Kenan* v. *Commissioner*, 114 F.2d at 219; *Commissioner* v. *S.A. Woods Mach. Co.*, 57 F.2d 635, 636 (1st Cir.), cert. denied, 287 U.S. 613 (1932); see also 2 B. Bittker, & L. Lokken *Federal Taxation of Income, Estates and Gifts*, para. 40.4, at 40-11 (1990); S. Surrey, P. McDaniel, H. Ault & S. Koppelman, *Federal Income Taxation* 928 (Successor ed. 1986). Thus, by transferring its truck terminals and the Key West property to the Pension Trust in satisfaction of its funding obligations, respondent accomplished precisely what Section 4975(c)(1)(A) explicitly prohibits—selling those properties to the Pension Trust.

Contrary to the view of the court of appeals in this case, the prior judicial decisions construing "sale or exchange" are not rendered "irrelevant" because they arose under the income tax provisions of the Internal Revenue Code. App., *infra*, 7a. To the contrary, the rationale of the decisions—that a transfer in fulfillment of an obligation is just a type of sale or exchange—is entirely applicable under Section 4975(c)(1)(A). Moreover, the phrase "sale or exchange" had acquired a settled judicial and administrative interpretation over the course of more than 50 years before Congress enacted even broader statutory language—embracing "*any* direct *or indirect* * * * sale or exchange"—in Section 4975. Congress was presumptively aware that the phrase "sale or exchange" embraced the transfer of property in satisfaction of an obligation when it enacted Section 4975. *Albernaz* v. *United States*, 450 U.S. 333, 341 (1981). Furthermore, the court of appeals, unlike the Fourth Circuit in *Wood*, declined to heed "[t]he normal rule of statutory construction * * * that 'identical words used in different parts of the same act are intended to have the same meaning,'" *Sorenson* v. *Secretary of the Treasury*, 475 U.S. 851, 860 (1986); see also *Ardestani* v. *INS*, 112 S. Ct. 515, 519 & n.2 (1991), as well as this Court's admonition in *Commissioner* v. *Lester*, 366 U.S. 299, 304 (1961) that "the Code must be given 'as great an internal symmetry and consistency as its words permit.'"

In addition, the result reached by the court of appeals in this case undermines Congress's purpose in enacting the prohibited transaction provisions of ERISA. Through Section 406 of ERISA and Section 4975 of the Internal Revenue Code, Congress sought to prevent transactions that present a significant potential for the loss of plan assets or for insider abuse. See *Leib* v. *Commissioner*, 88 T.C. 1474, 1481 (1987); see also *McDougall* v. *Donovan*, 552 F. Supp. 1206, 1215 (N.D. Ill. 1982); *Freund* v. *Marshall & Ilsley Bank*, 485 F. Supp. 629, 636-637 (W.D. Wis. 1979). Prior to the enactment of Section 4975, the applicable prohibited transaction rules imposed an "arm's-length" standard of conduct. S. Rep. No. 383, 93d Cong., 1st Sess. 32 (1973). The arm's-length standard, however, "require[d] substantial enforcement efforts, resulting in sporadic and uncertain effectiveness of these provisions." *Ibid.* In specifying several discrete categories of transactions that would be prohibited, Congress intended to "substantially strengthen[]" the prohibited transaction rules. *Ibid.* Sales and exchanges of property between insiders and pension plans were designated as prohibited transactions to ensure both the integrity of pension plans and that insiders did not use plans for their own interests. By establishing a clear rule,

Congress sought to eliminate the possibility that sales or exchanges of property between insiders and pension plans might not be at arm's-length, or might otherwise not be in the best interest of the plan. As the Fifth Circuit explained in *Donovan* v. *Cunningham*, 716 F.2d 1455, 1464-1465 (1983), cert. denied, 467 U.S. 1251 (1984), the object of the prohibited transaction provisions "was to make illegal per se the types of transactions that experience had shown to entail a high potential for abuse." Accord *Leib* v. *Commissioner*, 88 T.C. at 1481.

Transfers of property in satisfaction of funding obligations, as occurred in this case and in *Wood*, carry the potential for insider abuse that Congress sought to inhibit by prohibiting both direct and indirect sales or exchanges. As we have shown, a sponsoring employer may, in effect, sell property to a pension plan by contributing it to the plan. Thus, the purpose of Section 4975(c)(1)(A)—to protect pension plans against insider dealings—would be easily thwarted if the very same insiders that Congress sought to preclude from selling property to a plan were permitted to do so by transferring property to the plan in satisfaction of a funding obligation.

3. The court of appeals interpreted "sale or exchange" in Section 4975(c)(1)(A) contrary to its ordinary, settled meaning primarily on account of its construction of Section 4975(f)(3), which provides that "[a] transfer [of] real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien." The court of appeals read Section 4975(f)(3) as "implying that unless [property] is encumbered by a mortgage or lien, a transfer of property is not to be treated as if it were a sale or exchange." App., *infra*, 5a. In *Wood*, the Fourth Circuit addressed that conclusion and stated that "[b]ecause we find that § 4975(f)(3) serves the special need of expanding the scope of prohibition when *encumbered* property is involved, we find ourselves in disagreement with the reasoning of the Fifth Circuit's decision in *Keystone Consol. Indus.*" App., *infra*, 28a.

The Fourth Circuit gave Section 4975(f)(3) its more natural reading. Section 4975(f) sets out "other definitions and special rules." Section 4975(f)(3) contains a special rule providing that a transfer of encumbered property "shall be treated as" a sale or exchange. That supports the Fourth Circuit's conclusion that Congress intended Section 4975(f)(3) to expand the scope of the prohibited transaction provision. Under Section 4975(f)(3), even a transfer that would not normally be considered to be a sale or exchange, such as a voluntary transfer of property to a defined contribution plan by the plan's sponsor would be "treated as" a sale or exchange if the property were encumbered. But a special rule treating such a transaction as a sale or exchange should not be interpreted to restrict the normal meaning of "sale or exchange" so that indirect sales or exchanges—and, presumably, even direct ones—are permissible so long as the property involved is not encumbered.[9]

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[9] In *Wood*, the Fourth Circuit also properly rejected the taxpayer's argument that "the imposition of an excise tax on the contribution of property in satisfaction of indebtedness is inconsistent with 26 U.S.C. 404 of the Code, which permits plan sponsors to claim income tax deductions for their non-cash contributions to employee benefit plans." App., *infra*, 30a. In some situations—*e.g.*, where a purely voluntary contribution is made to a defined contribution plan—there is no tension at all between the provisions since the transaction

The court of appeals said that it saw "no basis" for distinguishing purely voluntary transfers of property from other transactions. App., *infra*, 6a. But such a distinction is inherent in Congress's scheme. By broadly prohibiting "any direct or indirect * * * sale or exchange" in Section 4975(c)(1)(A), Congress was addressing all transactions that are, in some sense, exchanges—such as respondent's transfers of property to satisfy its funding obligations. By adding in Section 4975(f)(3) that a transfer of encumbered property "shall be treated" as a sale or exchange, Congress provided that some transfers that are not exchanges, but are entirely voluntary, are also prohibited if engaged in by disqualified persons. At the same time, a transfer of unencumbered property that is not made to discharge an obligation is not prohibited; there is little room for abuse in such a case since, no matter what the plan receives, it is necessarily better off than it was before the transfer.[10]

is not prohibited by Section 4975 and a deduction is allowed under Section 404(a)(3). And the prohibited transaction provision is not actually in tension with Section 404 even in the case of a prohibited transaction: as the Fourth Circuit explained, "[a]lthough the excise tax of § 4975 discourages the contribution of non-cash property in satisfaction of a sponsor's funding obligation, it does not preclude the deductibility of these contributions." App., *infra*, 30a. Furthermore, if there is thought to be tension in allowing a deduction for a prohibited transaction, the taxpayer's position does not eliminate that tension because under everyone's construction of Section 4975 transfers of encumbered property are prohibited, but the fair market value of the transferred property is deductible under Section 404.

[10] The court of appeals suggested that there was no need to distinguish transfers that discharge obligations from purely voluntary transfers because Section 4971 imposes a tax on plans that are underfunded. But while there is some overlap between the purposes of Sections 4971 and 4975 because

Indeed, the construction given Section 4975 by the court of appeals in this case is contrary to common sense. The court properly read Section 4975(f)(3) as setting forth a protective rule providing that any contribution of encumbered property by a plan sponsor is prohibited, even if the transfer benefits the plan. At the same time, however, in light of its construction of Section 4975(f)(3), the court of appeals read Section 4975(c)(1)(A), contrary to the settled meaning of "sale or exchange," not to prohibit transactions such as occurred in *Wood*, where unencumbered property with a fair market value of $94,430 was transferred to a plan in satisfaction of a $114,000 funding obligation. Thus, the court of appeals construed the protection provided by Section 4975(f)(3) to undo the protection provided by Section 4975(c)(1)(A).

The court of appeals also read Section 4975(f)(3) out of its historical context. Section 4941, the statute after which Section 4975 was modeled, contains a provision, Section 4941(d)(2)(A), that is nearly identical to Section 4975(f)(3). Section 4941(d)(2)(A) provides, as a "special rule," that a transfer of encumbered property by a disqualified person to a private foundation "shall be treated as a sale or exchange," and therefore as "self-dealing." Contributions of property to private foundations, of course,

prohibited transactions may lead to underfunding, underfunding was not Congress's primary interest in enacting Section 4975. A sale between an insider and a pension plan is prohibited whether or not it results in underfunding. Indeed, such a sale is prohibited by Section 4975(c)(1)(A) even if it is undisputed that the plan paid fair market value for the property. Section 4971, on the other hand, imposes a tax on accumulated funding deficiencies whether caused by plan losses, insider transactions, or otherwise.

typically are *not* made in satisfaction of legal obligations. Hence, it is clear that the central function of Section 4941(d)(2)(A) is to prohibit *voluntary* transfers of encumbered property by disqualified persons to private foundations. It would make no sense at all to conclude that Section 4941(d)(2)(A) *excludes* from the scope of prohibited self-dealing a transfer of property to a private foundation in satisfaction of an indebtedness owed to the private foundation. Cf. Rev. Rul. 81-40, *supra*; Rev. Rul. 77-379, *supra*.

4. The decision of the court of appeals poses a serious threat to the ability of the Internal Revenue Service to carry out its congressional mandate to ensure that insiders do not use pension plans for self-dealing. The question presented is a recurring one that is of substantial administrative importance since it affects all employers who might transfer property to qualified pension plans to satisfy their funding obligations. The IRS estimates that, in 1989 alone, in-kind property with a total purported fair market value of more than $243 million was contributed by employers to more than 400 separate plans. In the IRS's view, many of those contributions were prohibited transactions. Resolution of the recurring question presented by this case is needed to avoid continuing uncertainty and to ensure even-handed application of the revenue laws.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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APRIL 1992

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 91-4208

KEYSTONE CONSOLIDATED INDUSTRIES, INC.,
PETITIONER-APPELLEE

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT-APPELLANT

Appeal from a decision of the United States
Tax Court

Jan. 17, 1992

Before JOLLY, JONES, and EMILIO M. GARZA, Circuit Judges.

E. GRADY JOLLY, Circuit Judge:

Keystone, the taxpayer, transferred property to its tax qualified defined benefit pension plan in satisfaction of its statutory minimum funding requirements.

The Commissioner asserted that this transfer of property in satisfaction of an obligation was a sale or exchange within the meaning of Section 4975(c)(1)(A), and therefore asserted tax deficiencies under Section 4975(a) and (b).

Keystone filed suit in the tax court, contending that it was not liable for the deficiencies. The tax court granted summary judgment in favor of Keystone, holding that neither the plain language of the statute nor the congressional intent in drafting it suggests that Section 4975 was meant to apply to the transfer of unencumbered property. We agree with the tax court's reasoning, and therefore affirm the tax court's order.

I

The relevant facts are undisputed. Keystone Consolidated Industries, Inc. ("Keystone") maintained several tax qualified defined benefit pension plans. The plans were subject to the minimum funding requirements of Section 302 of ERISA. 26 U.S.C. § 412. Keystone funded the plans through contributions to the Keystone Consolidated Master Pension Trust (the "Trust").

In 1983, Keystone contributed five truck terminals to the Trust. Keystone credited the fair market value of the terminals against its statutory minimum funding obligations for its taxable years ending on June 30, 1982 and June 30, 1983. In March of 1984, Keystone contributed real property to the Trust and credited the fair market value of this property against its statutory funding obligations for the tax year ending on June 30, 1984.

The terminals and the property were not subject to any mortgage at the time they were transferred

to the Trust. The terminals and the real property were not the subject of any leaseback agreements with Keystone.

Keystone claimed deductions in the amount of the fair market value of the terminals and the real property under Section 404 of the Internal Revenue Code. Keystone reported the difference between its cost to acquire those properties and their fair market value at the time of their transfer as capital gains from the sale or exchange of an asset under Section 1222.

The Tax Commissioner determined that Keystone's transfer of the truck terminals and real property to the Trust in satisfaction of its statutory funding requirements was a "sale or exchange" within the meaning of Section 4975(c)(1)(A) of the Code, and was therefore a prohibited transaction. Accordingly, the Commissioner asserted tax deficiencies under Section 4975(a) and (b).

II

Keystone filed a petition in the tax court contesting its liability for these deficiencies. The Commissioner argued that it is well established that a transfer of property in satisfaction of indebtedness is treated as a sale or exchange. The Commissioner also argued that the congressional intent behind the prohibited transactions provision is consistent with his view of a sale or exchange.

The tax court decided the case on cross-motions for summary judgment. The tax court held that the transfers were not sales or exchanges. The court held that a definition of the sale or exchange that involves the transfer of property is provided by Section 4975(f)(3), which states that a transfer of property encumbered by a mortgage or a lien, which the plan

assumes, shall be treated as a sale or exchange. The tax court noted that neither the terminals nor the real property was subject to a mortgage or lien, and therefore, held that the transfers were not sales or exchanges. The Commissioner now appeals.

III

On appeal, the Commissioner argues mainly that Section 4975(f)(3) is not the exclusive definition of a sale or exchange that involves the transfer of property. He argues that this definition applies only to voluntary transfers of property, i.e., transfers over and above minimum funding requirements, and that involuntary transfers of property, i.e., transfers to satisfy minimum funding requirements, are sales or exchanges irrespective of Section 4975(f)(3). Keystone argues that according to the plain language of the statute, only transfers of encumbered property are to be treated as sales or exchanges under Section 4975.

IV

Thus, we are presented with the question whether a taxpayer's contribution of property to a tax qualified defined benefit pension plan in satisfaction of its statutory funding requirements is a sale or exchange under Section 4975(c)(1)(A). Section 4975(c)(1)(A) defines a prohibited transaction as any direct or indirect "sale or exchange, or leasing, of any property between a plan and a disqualified person." Section 4975(a) imposes a tax on the disqualified person equal to five percent of the amount involved in the prohibited transaction. Section 4975(b) imposes an additional tax on the prohibited transaction equal to one hundred percent of the amount involved. This

tax may be avoided by correcting the transaction within the taxable period. Keystone is a disqualified person under Section 4975(e)(2)(C). The tax qualified defined benefit pension plan at issue is a plan covered by Section 4975. 26 U.S.C. § 4975(e)(1). Therefore, the only question we are required to decide is whether the contribution of property was a sale or exchange under Section 4975(c)(1)(A).

V

Keystone argues that in accordance with Section 4975(f)(3), only a transfer of property that is subject to a mortgage or lien is to be treated as a sale or exchange.[1] We agree with the taxpayer. If all transfers of property to a plan were to be treated as a sale or exchange, then this definition would be superfluous. The definition states that a transfer of property encumbered by a mortgage or lien *shall be treated* as a sale or exchange, implying that unless it is encumbered by a mortgage or lien, a transfer of property is not to be treated as if it were a sale or exchange.

The Commissioner argues that this definition of a sale or exchange that involves the transfer of property is not an exclusive definition; he argues that if

[1] Section 4975(f)(3) provides:

(f) Other definitions and special rules.—For purposes of this section—

(3) Sale or exchange; encumbered property.—A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transaction.

Congress had intended it to be, it would have said a sale or exchange includes *only* these transfers. The Commissioner argues that Section 4975(f)(3) is not superfluous because it applies to voluntary transfers. He argues that involuntary transfers of property, that is, transfers in satisfaction of a statutory obligation, are "exchanges," irrespective of Section 4975(f)(3).

We cannot accept the Commissioner's arguments. In the first place, there is no basis for this distinction between involuntary and voluntary transfers anywhere in the Code. Furthermore, this distinction also makes no economic sense. A contribution is involuntary because the contribution is required to satisfy the minimum funding requirement for that year. However, when an employer makes a voluntary contribution to a plan, he effectively supplements the assets of the plan, receives a credit in his funding standard account, and thereby reduces the amount of mandatory contributions in future years. 26 U.S.C. § 412. The potential for abuse, that is, satisfaction of minimum mandatory obligations to the pension fund with property with inflated values, would be the same regardless of whether the transfer was involuntary. Thus, there is neither statutory nor economic support for the Commissioner's argument.

The Commissioner argues further that the congressional intent behind the prohibited transaction provision supports his interpretation of "sale or exchange." We disagree. The Commissioner only points to one excerpt from a Senate Report that states that one of the principle purposes of Section 4975 was to prevent the possibility that a non-arm's length transaction might go undiscovered. The Commissioner offers no evidence that Congress intended Section 4975

(a)(1)(A) to apply to the transfer of unencumbered property. Accordingly, we reject the Commissioner's statutory construction of Section 4975(f)(3).

Next, he argues that it is well established that a transfer of property in satisfaction of a debt or a bequest is a sale or exchange. The fact that a transfer of property is treated as a sale or exchange for income tax purposes is not determinative of whether the same transaction is a sale or exchange under the prohibited transaction provision. The meaning of "sale or exchange" depends on the context and the particular statute at issue. *United States v. Davis*, 370 U.S. 65, 69 n. 6, 82 S.Ct. 1190, 1192 n. 6, 8 L.Ed.2d 335 (1962); *Helvering v. Hammel*, 311 U.S. 504, 507, 61 S.Ct. 368, 369-70, 85 L.Ed. 303 (1941). Section 4975 was not enacted to measure economic income; it was enacted to prohibit a specific list of self-dealing transactions between a plan and an employer. Therefore, the fact that the transfer of property in satisfaction of a debt or obligation is a sale or exchange for purposes of the income tax statutes is irrelevant to whether the same transfer is a sale or exchange prohibited by Section 4975.

The Commissioner argues next that the administrative views of the Commissioner, the IRS and the Department of Labor should be given deference. He argues that the IRS and the Department of Labor have found that similar transfers of property to pension funds were sales or exchanges under other sections of the Code and ERISA.[2] The Commissioner

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[2] The IRS, in two revenue rulings, found that the transfer of property to a private foundation was a sale or exchange, making the transfer an act of self-dealing subject to a tax under Section 4941. Rev.Rul. 81-40, 1981-1 C.B. 508; Rev. Rul. 77-379, 1977-2 C.B. 387. The DOL, in an advisory opin-

has never promulgated any regulation declaring a transfer of property to be a sale or exchange. In fact, the Commissioner asserted his argument for the first and only time prior to this case in *Wood v. Comm'r*, 95 T.C. 364 (1990), and the Tax Court rejected it. Under these circumstances, the Commissioner's views are not entitled to any deference. The Department of Labor's advisory opinion is binding only on the parties thereto, and has no precedential effect. ERISA Proc. 76-1, § 10. The revenue rulings deal with Section 4941, which, although similar to Section 4975, contains no definition of a sale or exchange as found in Section 4975(f)(3). Consequently, we find these revenue rulings inapposite.

The Commissioner also argues that because there is a real potential for abuse when a transfer of property is made, such a transfer should be prohibited. The potential for abuse is already restrained by Section 4971. Any funding deficiencies caused by the contribution of an overvaluated asset are taxed under Section 4971.

Finally, the Commissioner argues that the tax under Section 4974 is not a penalty tax, and can therefore be construed broadly.[3] We do not decide whether the

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ion, found that the contribution of unencumbered property by an employer to a pension plan was a sale or exchange under Section 406 of ERISA. DOL Advisory Opinion 81-69A (July 28, 1981).

[3] The Commissioner cites *Latterman v. U.S.*, 872 F.2d 564, 568-570 (3d Cir. 1989), in which the court found that the tax imposed by Section 4975 is not a penalty. Keystone argues that this court found that the two tier tax imposed under Section 4941, the statute upon which Section 4975 was modeled, is a penalty tax. *In re Unified Control Systems, Inc.*, 586 F.2d 1036 (5th Cir.1978).

tax imposed by Section 4975 is a penalty tax. Even assuming that it is not a penalty tax and that, therefore, Section 4975 can be construed broadly, a sale or exchange under Section 4975 cannot be construed to include transfers of unencumbered property.

VI

In conclusion, because the plain language of the statute does not include the transfer of unencumbered property to a pension plan as a sale or exchange, and because the Commissioner's arguments that additional words should be read into the statute are unconvincing, we hold that the transfer in this case was not a sale or exchange for purposes of Section 4975(c)(1)(A). The order of the tax court is therefore

AFFIRMED.

APPENDIX B

UNITED STATES TAX COURT

T.C. Memo. 1990-628

KEYSTONE CONSOLIDATED INDUSTRIES, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 4657-89. Filed December 13, 1990.

MEMORANDUM FINDINGS OF FACT AND OPINION

HAMBLEN, *Judge*: Respondent issued a notice of deficiency to petitioner for excise taxes for fiscal years (ending June 30) 1983, 1984, 1985, 1986, 1987, and 1988. The notice of deficiency determined that two transfers of property by petitioner to its employee's pension plan, in satisfaction of petitioner's funding obligations, were prohibited transactions under section 4975.[1] Petitioner timely filed its petition contesting the deficiency. This matter now comes before the Court on petitioner's motion for summary judgment. Respondent has submitted a cross-motion for summary judgment in his favor. The sole issue for determination is whether petitioner's transfer of unencumbered property to a pension plan, established for the benefit of petitioner's employees, in satisfaction of petitioner's minimum funding obligations, constitutes a sale or exchange within the meaning of section 4975.

[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect for the years in issue and all Rule references are to the Tax Court Rules of Practice and Procedure.

FINDINGS OF FACT

The following facts have been stipulated to by the parties. The attached exhibits are incorporated herein by this reference.

Keystone Consolidated Industries, Inc., (hereinafter petitioner) is incorporated under the laws of the State of Delaware. Petitioner's principal office is in Dallas, Texas.

During the taxable years ending June 30, 1983 through June 30, 1988, petitioner maintained several tax-qualified defined benefit plans. Petitioner funded these plans through contributions to the Keystone Consolidated Master Pension Trust (hereinafter the Trust).

On March 8, 1983, petitioner contributed to the Trust five truck terminals (hereinafter the truck terminals) having a fair market value of $9,655,454. Petitioner credited the fair market value of the truck terminals against its minimum funding obligations of the employees' defined benefit plans for the taxable years ending June 30, 1982 and 1983.

On March 13, 1984, petitioner contributed to the Trust real property (hereinafter the Key West property) having a fair market value of $5,336,751. Petitioner credited the fair market value of the Key West

property against its minimum funding obligations of the employees' defined benefit plans for the taxable year ending June 30, 1984.

The truck terminals and Key West property transferred from petitioner to the trust were not encumbered or subject to any mortgage at the time of the transfer. Further, the truck terminals and the Key West property were never leased back to petitioner or any "affiliate" of petitioner.

Petitioner reported these transactions on its income tax returns, taking a deduction in the amount of the fair market value of the property transferred as a contribution to the plan under section 412, and recognizing the difference between the cost of such property and its fair market value as taxable capital gain.

On December 14, 1988, respondent issued a notice of deficiency for excise taxes against petitioner for the fiscal taxable years ending June 30 for 1983, 1984, 1985, 1986, 1987, and 1988. Respondent determined excise taxes owing in the amount of $749,610 for the fiscal year ending June 30, 1984 and $482,773 for each of the other taxable fiscal years at issue. Further, respondent determined an additional excise tax owing for the taxable fiscal year ending June 30, 1988 in the amount of $9,655,454. Petitioner timely filed a petition contesting the determined deficiencies on March 9, 1989.

OPINION

Both respondent and petitioner agree that there are no genuine issues of material fact before the Court in this case. Therefore, judgment on the substantive issue as a matter of law is appropriate. Rule 121(b). See *Espinoza v. Commissioner*, 78 T.C. 412, 416 (1982); *Jacklin v. Commissioner*, 79 T.C. 340, 344 (1982).

Respondent's contention for the determined deficiencies is that property transferred by petitioner to its employees' pension plan in satisfaction of petitioner's funding obligations constitutes a prohibited transaction under section 4975. Respondent does not contest the value set forth by petitioner of the truck terminals or of the Key West property. Therefore, the sole issue before us is whether the transfer of unencumbered property by an employer to a defined benefit plan, maintained for the benefit of its employees, in satisfaction of the employer's minimum funding requirements, is a prohibited transaction when the employer does not retain, directly or indirectly, any control over the transferred property.

Section 4975(a) imposes on "prohibited transactions" an annual five percent tax on the amount involved for each "prohibited transaction" (the "first-tier" tax). The tax imposed is to be paid by any "disqualified person" who participates in the prohibited transaction. Additionally, section 4975(b) imposes a 100 percent tax on any "prohibited transaction" not corrected within the statutory period (the "second-tier" tax). Section 4975(c)(1)(A) defines "prohibited transaction," in part, as any "sale or exchange," or leasing, of any property between a "plan" and a "disqualified person." Section 4975(e)(2)(C) defines a "disqualified person," in part, as an employer, any of whose employees are covered by the "plan." Section 4975(e)(1) sets forth that a trust forming a part of a plan constitutes a "plan" for purposes of section 4975. Therefore, for our purposes, the tax imposed by section 4975(a) must be paid by any employer who enters into a sale or exchange, or lease, with any plan that covers some of the employer's employees.

Petitioner acknowledges that it is a disqualified person with respect to the Trust. Petitioner further acknowledges that the Trust qualifies as a plan under section 4975. Consequently, we must determine only whether the transfers are sales or exchanges pursuant to section 4975(c)(1)(A), and, as such, prohibited.

Respondent argues that petitioner's transfer of unencumbered property to the Trust in satisfaction of its minimum funding obligations constitutes a sale or exchange for purposes of section 4975. Respondent further asserts that this Court should broadly construe the term "sale or exchange" in order to prevent potential abuse. While we agree with respondent that there is a potential for abuse by allowing unencumbered property transfers to plans in satisfaction of minimum funding requirements, we do not agree that the transfer in this case constitutes a sale or exchange under section 4975.

First, respondent attempts to analogize the property transfer to the recognition of income for income tax purposes. Respondent cites authority relating to the recognition of gain on the transfer for income tax purposes and makes the analogy that the same treatment should be afforded in the area of contributions to pension plans. However, the issue of whether a transfer to a pension plan is a prohibited transaction under section 4975 is separate and distinct from income tax recognition. Further, detailed definitions of a sale or exchange for purposes of the prohibited transaction rules should be applied in lieu of general definitions found in other areas of the tax law. See, e.g., *Essenfeld v. Commissioner*, 37 T.C. 117, 122-123 (1961) (quoting *United States v. Chase*, 135 U.S. 255, 260 (1890)), affd. 311 F.2d 208 (2d Cir. 1962). Since section 4975(f)(3) specifically describes certain transfers of real or personal property to a plan by a disqualified person as a sale or exchange for purposes of section 4975, the definitional concerns of "sale or exchange" are removed from the general definitions found in other areas of the tax law. See *Energy Resources Ltd. v. Commissioner*, 91 T.C. 913, 916-917 (1988). Therefore, we do not find respondent's analogy appropriate or persuasive.

Second, respondent contends that employers could transfer "bad" or "illiquid" investments to the plan, thereby hurting the plan's rate of return and investment policies. However, it is the fair market value of the asset at the time of the transfer that controls for valuation purposes. "Bad" or "illiquid" assets would, at least in some part, be reflected by a lower fair market value. Further, respondent has ample opportunity to contest the value of the asset at the time of transfer. Respondent makes no such contention in the present case. Once the asset is transferred, the trustee of the plan must make its independent judgment as to how to treat the asset. If the asset is truly a poor investment, the trustee, acting under its fiduciary capacity, can dispose of it.

We do find merit in respondent's argument that the employer can save costs related to the sale of the asset by transferring it into a plan, rather than selling it outright. However, this potential for abuse is better addressed by Congress. If Congress intended to prevent unencumbered property from being transferred into a plan in satisfaction of the employer's minimum funding requirements, it would have included unencumbered property in section 4975

(f)(3).[2] Respondent's contention that Congress intended transfers of unencumbered property to be prohibited transactions is inconsistent with section 4975(f)(3) which specifies only transfers of encumbered property as a prohibited transaction. In construing the terms of section 4975 "* * * in harmony with the legislative purpose" as respondent suggests (citing *Gruver v. Commissioner*, 142 F.2d 363, 366 (4th Cir. 1944)), it is clear that the Code, and the legislative intent behind it, does not support respondent's determination that petitioner's transfer of unencumbered property to its plan in satisfaction of its funding obligation is a prohibited transaction.

Next, respondent argues that Congress intended to allow unencumbered property to be transferred to a plan only when the transfer was voluntary (i.e., not in satisfaction of the minimum funding requirements of section 412). Respondent further argues that the Code should be read to limit all transfers of property, including unencumbered property, if it satisfies any of the employer's minimum funding obligations. We do not agree. Nothing in section 4975, or related sections, even hints that Congress made a distinction between voluntary and mandatory contributions as they relate to transfers of unencumbered property. To the contrary, Congress made distinctions relating to transfers of property based on other factors.[3] Further, we draw attention to our

[2] Section 4975(f)(3) treats the transfers of encumbered real or personal property by a disqualified person to a plan as a sale or exchange, and thus a prohibited transaction, if the plan assumes the encumbrance or if the encumbrance was placed upon the property by the disqualified person within the last ten years.

[3] See discussion concerning section 4975(f)(3) *infra.*

recent holding, directly on point, where we found that "Nothing in the provisions * * * persuades us that an unexpressed distinction between voluntary and required contributions should be read into the provisions dealing specifically with qualified pension plans." *Wood v. Commissioner*, 95 T.C. —— (Sept. 27, 1990) (slip op. at 10).

We have reviewed respondent's other arguments and find them wholly unpersuasive and without merit. We find no persuasive indication that section 4975 was intended by Congress to make a distinction between voluntary and required contributions to pension plans. Further, we find no credible support to suggest that section 4975, or Congress's intent in drafting it, was intended to restrict the transfer of unencumbered property to a plan in satisfaction of an employer's minimum funding requirements.

For the foregoing reasons,

An appropriate order will be issued.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 91-1717

DALLAS C. WOOD, PETITIONER-APPELLEE

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT-APPELLANT

Appeal from the United States Tax Court
(Tax Ct. No. 89-322)

Argued: October 1, 1991

Decided: January 31, 1992

Before WIDENER and NIEMEYER, Circuit Judges, and MERHIGE, Senior United States District Judge for the Eastern District of Virginia, sitting by designation

OPINION

NIEMEYER, Circuit Judge:

Section 4975 of the Internal Revenue Code imposes an excise tax on any "disqualified person" who participates in a "prohibited transaction" with a qualified defined benefit plan created under ERISA. We are presented with the question of whether the assignment of third-party promissory notes by a disqualified person to a plan in discharge of a funding obligation is a prohibited transaction. The Tax Court determined that it was not. The Commissioner of Internal Revenue appeals, viewing the transaction as a "sale or exchange" of property that is prohibited by 26 U.S.C. § 4975(c)(1)(A) (1988). We agree and therefore reverse.

I

During the years in issue, Dallas Wood was a self-employed real estate broker in Fairfax County, Virginia. As permitted by ERISA, Wood adopted the Dallas C. Wood Defined Benefit Plan ("the plan"), effective January 1, 1984. While Wood is the plan's sole participant and serves as plan administrator and trustee, he relied on an actuary to establish, fund, and operate the plan. The plan, which is subject to the ERISA minimum funding requirements of 26 U.S.C. § 412, permits the receipt of non-cash contributions in satisfaction of its funding requirements. As calculated by the actuary, applying an "aggregate level cost method," the cost of funding the plan for the year which ended December 31, 1984 was $114,000.

In order to meet this funding obligation, Wood contributed three promissory notes with face values totalling $114,000. One note in the face amount of

$60,000 made payable to Wood was received by him in 1983 when he sold his principal residence. The remaining two notes, in the face amounts of $39,000 and $15,000, were executed by purchasers in real estate transactions in which Wood acted as a broker. He purchased these notes at a discount for $32,000 and $11,250, respectively. The notes were transferred to the plan "without recourse" in 1984 and 1985, and by 1986 they all were paid in full.

On his 1984 Federal income tax return, Wood claimed a deduction of $114,000, representing the combined face amount of the notes he contributed to the plan, although the total fair market value of the notes at the time they were transferred to the plan was only $94,430. Wood did not report any gain as a result of this transfer. The parties have now stipulated, however, that the contribution of the notes was a recognition event for income tax purposes and have agreed that Wood was, and is, required to report as capital gains the difference between the face value of the notes and his basis in the notes.

In 1988 the IRS issued a notice of deficiency, having determined that Wood was liable for excise taxes under 26 U.S.C. § 4975(a) in the amount of $3,000 for 1984, $5,700 for 1985, and $5,700 for 1986, representing five percent of the third-party notes contributed as of each of those years. The IRS also imposed penalties for failure to pay the taxes timely.

Wood challenged the determinations of the IRS by filing a petition with the Tax Court for redetermination of the deficiency. The Tax Court agreed with Wood and held that Wood's contribution of third-party promissory notes to the plan was not a prohibited transaction within the meaning of § 4975(c) and that therefore he was not liable for excise taxes. It

reasoned that there is nothing in the Code which precludes the *contribution* of non-cash property to fund a pension trust. As the Tax Court stated:

> In summary, we conclude that nothing in ERISA changes prior law permitting transfers of property to a pension trust. We believe that, if such a change had been intended, Congress would have said so directly rather than by the imposition of a tax under section 4975.

This appeal followed.

II

The Employee Retirement Income Security Act of 1974 (ERISA) was enacted in response to the enormous growth and development of private pension systems, and reflects the congressional concern that certain safeguards be imposed to provide adequate retirement security for plan participants and their beneficiaries. *See* Pub. L. No. 93-406, 88 Stat. 829, 832-33 (1974). It is a comprehensive remedial scheme designed to protect the pensions and benefits of employees by addressing not only the "malfeasance and maladministration in the plans, or the consequences of lack of adequate vesting, but also . . . the broad spectrum of questions such as adequacy of [plan] funding" to pay promised benefits. H.R. Rep. No. 533, 93d Cong., 1st Sess. 9-10 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4647-4648.

As part of Title II of ERISA, which is administered by the Internal Revenue Service, Congress enacted a prohibited transactions rule to prevent persons with a close relationship to a plan from using that relationship to the detriment of plan beneficiaries. Section 4975 of the Internal Revenue Code imposes two levels of excise tax on "any disqualified

person who participates in [a] prohibited transaction." 26 U.S.C. § 4975(a), (b). It expressly prohibits the direct or indirect:

> (A) sale or exchange, or leasing of any property between a plan and a disqualified person;
>
> (B) lending of money or other extension of credit between a plan and a disqualified person;
>
> (C) furnishing of goods, services, or facilities between a plan and a disqualified person;
>
> (D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;
>
> (E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or
>
> (F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

26 U.S.C. § 4975(c). There is no dispute in this case that Wood is a disqualified person. *See* 26 U.S.C. § 4975(e)(2). The primary point of contention is whether Wood's contribution of third-party promissory notes to the plan is a sale or exchange of property, and thus a prohibited transaction within the meaning of § 4975(c).

The Commissioner contends that the taxpayer's contribution of third-party promissory notes in satisfaction of the statutory funding obligation is a sale or exchange within the meaning of § 4975(c). He argues that the term "sale or exchange" should be given the same meaning as it is given throughout the Tax Code,

including the common notion that a transfer of property in satisfaction of indebtedness constitutes a "sale or exchange" of property. *See, e.g., Rogers v. Commissioner*, 103 F.2d 790, 792-93 (9th Cir.), *cert. denied*, 308 U.S. 580 (1939). Furthermore, the Commissioner argues that transferring property to the plan in satisfaction of an obligation to fund the plan is no different from satisfying the obligation with cash and then causing the plan to use the cash to purchase the property. The Commissioner observes that this interpretation is consistent with the legislative history and the interpretation given to 29 U.S.C. § 1106, a parallel provision in the portion of ERISA administered by the Department of Labor.

Wood acknowledges that § 4975 prohibits sales and exchanges between him and the plan in some circumstances. He readily agrees that if he had funded the plan with cash and then caused the plan to use the cash to purchase the third-party promissory notes from himself, the transaction would be prohibited by § 4975(c). He contends, however, that the prohibition applies only to the *operation and management* of a defined benefit plan, and does not pertain to *contributions* of property to fund the plan. He argues that under the structure of the Tax Code, §§ 4971, 4972, 4973 and 4979 address "the contribution phase" of a plan, imposing taxes for insufficient or improper contributions. Sections 4974 and 4975 (involved here) regulate the "operational phase," imposing taxes on improper management or improper transactions during the course of operations. And finally, he notes that §§ 4976 through 4980B, with the exception of § 4979, govern the "distribution phase" of a plan. In further support of his structural argument that § 4975 does not apply to contributions, Wood points out that

§ 4975 nowhere uses the word "contribution." If Congress intended the section to apply to non-cash contributions, he asserts, it would have said so as it did in sections specifically applicable to the contribution phase.

Alternatively Wood argues that his contribution of third-party promissory notes did not constitute a sale or exchange because § 4975(f)(3) limits the definition of "sale or exchange" to transfers of *encumbered* property. He observes that the Commissioner's interpretation would prohibit funding any plan with stocks, bonds, or any readily salable assets, regardless of their safety, a result that Wood suggests is irrational. Finally, Wood contends that § 4975 must be interpreted in a manner consistent with 26 U.S.C. § 404, which permits him to claim income tax deductions for non-cash contributions to his employee benefit plan.

It was clearly the intent of Congress to prohibit categorically disqualified persons from entering into specified transactions with the plans they sponsor, as such dealings are susceptible to abuse and put in jeopardy the plan's ability to pay promised benefits. Prior to the enactment of § 4975, prohibited transactions rules relied on an "arm's-length" standard of conduct, which "require[d] substantial enforcement efforts, resulting in sporadic and uncertain effectiveness of these provisions." S. Rep. No. 383, 93d Cong., 1st Sess. 32 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4890, 4917. In specifying several categories of transactions that would be subject to the excise tax, Congress intended to displace the "arm's-length" standard with a per se rule which would "substantially strengthen" the laws governing prohibited transactions. *Id.* The purpose of designating sales and ex-

changes of property between insiders and pension plans as prohibited transactions was to ensure pension plan integrity by eliminating even the possibility that such sales or exchanges might not be at arm's length. *See Donovan v. Cunningham*, 716 F.2d 1455, 1464-65 (5th Cir. 1983) (interpreting 29 U.S.C. § 1106, a parallel prohibited-transaction provision in Title I of ERISA), *cert. denied*, 467 U.S. 1251 (1984). Thus, the prohibition against sales or exchanges of property between a plan and a disqualified person is intended to avoid the potential for overvaluations of property to the detriment of the plan, precisely as occurred in this case when Wood purported to discharge a $114,000 obligation with third-party promissory notes having a value of only $94,430. The implementation of this purpose would suggest that all sales or exchanges with the plan by disqualified persons should be prohibited, whether as a contribution or during the operation of the plan.

Wood's structural argument, that the excise tax provisions are organized according to certain phases in a plan's existence and that § 4975 applies only to transactions occurring during the so-called "operational phase," finds little support in the Code. Wood labels §§ 4971, 4972, 4973, and 4979 as sections which apply only to a plan's "contribution phase." While §§ 4971 through 4973 follow in sequence and might otherwise tend to suggest an organizational theme, § 4979 is located in the middle of what Wood labels the "distribution phase" provisions. Furthermore, the applicability of § 4971 is not limited to plan contributions. Section 4971 imposes an excise tax when there is an "accumulated funding deficiency," the existence of which is determined on the basis of the *cumulative* charges and credits to the funding stand-

ard account "for all plan years." 26 U.S.C. §§ 4971 (c)(1), 412(a).

The excise tax sections applicable to pension plans are not structured in accordance with a plan's developmental phases. Rather, the provisions prohibit specific transactions, events, and circumstances that pose a significant threat to the integrity of pension plans and discourage certain benefits that were not of the type Congress favored. Section 4975(c) does not mention the words "contribution," "operation," or "distribution," but instead prohibits without qualification "*any* direct or indirect . . . sale or exchange . . . of any property between a plan and a disqualified person." 26 U.S.C. § 4975(c)(1) (emphasis added). Its blanket prohibition regulates transactions which occur between a plan and a disqualified person because of the potential for abuse inherent in that close relationship. It is immaterial whether the transaction involves a contribution, a distribution, or something in between. In fact, Treasury Regulation § 1.415-6 (b)(4) (1981) (amended in 1991 in respects not material here) addresses the applicability of § 4975 to contributions, and provides:

> *Contributions other than cash.* For the purposes of this paragraph, a contribution by the employer or employee of property other than cash will be considered to be a contribution in an amount equal to the fair market value . . . of the property on the date the contribution is made. *The contribution described in this subparagraph may, however, constitute a prohibited transaction within the meaning of section 4975(c)(1).*

(emphasis added). We therefore conclude that any sale or exchange of non-cash property between a plan

and a disqualified person is a prohibited transaction, whether undertaken for the purpose of making a contribution or otherwise.

Wood contends alternatively that even if § 4975 applies to contributions, his contribution of third-party notes in discharge of his obligation to fund the plan did not constitute a "sale or exchange" as that term is used in § 4975. He argues that § 4975(f)(3) defines only transfers of property encumbered by mortgages or liens as "sales or exchanges" under § 4975 and that therefore the transfer of *unencumbered* property (as is involved here) is not subject to the § 4975 prohibition. The recent Fifth Circuit decision in *Keystone Consol. Indus., Inc. v. Commissioner*, No. 91-4208, 1992 WL 168 (5th Cir. 1992), supports this position.

Section 4975(f)(3) states:

> Sale or exchange; encumbered property.—A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

We do not view § 4975(f)(3) as a special rule limiting the applicability of the excise tax to contributions of encumbered property. On the contrary, its inclusion reveals the intent of Congress to expand the definition of "sale or exchange" as generally understood to include *all transfers* to a plan of *encumbered* property, whether or not in discharge of a debt, because transfers of encumbered property present a

particularly significant potential for abuse. The expansive meaning of § 4975(f)(3) is revealed by the general use of "sale or exchange" under the Internal Revenue Code and the application of the principle that "the Code must be given 'as great an internal symmetry and consistency as its words permit.'" *Commissioner v. Lester*, 366 U.S. 299, 304 (1961) (*quoting United States v. Olympic Radio & Television, Inc.*, 349 U.S. 232, 236 (1955)). Moreover, "[t]he normal rule of statutory construction assumes that 'identical words used in different parts of the same act are intended to have the same meaning.'" *Sorenson v. Secretary of the Treasury*, 475 U.S. 851, 860 (1986) (citations omitted). Because we find that § 4975 (f)(3) serves the special need of expanding the scope of prohibition when *encumbered* property is involved, we find ourselves in disagreement with the reasoning of the Fifth Circuit's decision in *Keystone Consol. Indus.*

The general treatment of the transfer of property in satisfaction of indebtedness as a sale or exchange for tax purposes is long-standing. *See Rogers*, 103 F.2d at 792-93; *Pender v. Commissioner*, 110 F.2d 477, 478 (4th Cir.), *cert. denied*, 310 U.S. 650 (1940). Although the term appears primarily in the income tax chapter, *see, e.g.*, 26 U.S.C. §§ 62, 64, 65, we are aware of no instance when the term "sale or exchange" has been used or interpreted not to include transfers of property in satisfaction of indebtedness.

We note also that the IRS has applied the generally accepted definition to the "sale or exchange" language of § 4975 and has construed the transfer of property in satisfaction of a sponsor's statutory funding obligation as a sale or exchange. *See* Rev. Rul. 80-140, 1980-1 C.B. 89. It is well-established that consider-

able weight is to be given to an agency's construction of a statute that it is charged with administering. *See Udall v. Tallman*, 380 U.S. 1, 16 (1965); *see also Rose v. Long Island RR Pension Plan*, 828 F.2d 910, 918 (2d Cir. 1987) ("Because the IRS is one of the agencies charged with administering ERISA, its interpretations of the statute are entitled to great deference."), *cert. denied*, 485 U.S. 936 (1988).

Finally, we are persuaded by the interpretation given to a parallel ERISA provision by the Department of Labor, which is responsible for administering Title I of ERISA. The Labor Department has interpreted 29 U.S.C. § 1106, which also prohibits a plan fiduciary from engaging in a transaction that he knows or should know constitutes a direct or indirect sale or exchange of property between the party and a party in interest, to preclude the transfer of non-cash property in satisfaction of a sponsor's funding obligation. *See* Dept. of Labor Op. 81-69A (July 28, 1981); Dept. of Labor Op. 90-05A (March 29, 1990). We find it particularly noteworthy that the legislative history of § 4975 indicates that Congress intended that the prohibited transaction rules in the labor and tax titles apply in a similar manner to like transactions. *See* H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 295-96 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5076.

Accordingly we conclude that it is appropriate to apply the generally recognized definition of "sale or exchange" to § 4975, and, in so doing, we reject Wood's contention that § 4975(f)(3) limits this definition to transfers of encumbered property. While the transfer to a plan of unencumbered property becomes a sale or exchange only if the transfer satisfies a funding obligation, when encumbered property is in-

volved *all* transfers to the plan are prohibited, regardless of whether they are contributed in satisfaction of a pre-existing debt.

As a final matter, Wood argues that the imposition of an excise tax on the contribution of property in satisfaction of indebtedness is inconsistent with 26 U.S.C. § 404 of the Code, which permits plan sponsors to claim income tax deductions for their non-cash contributions to employee benefit plans. *See Colorado Nat'l Bank v. Commissioner*, 30 T.C. 933 (1958) (holding that contributions of real property to a pension trust fund are deductible under § 404), *acq. in result*, 1959-1 C.B. 3. He alleges that because Congress permits deductions for contributions of property under § 404, it is inconceivable that it intended to impose an excise tax on these same transactions under § 4975.

The Internal Revenue Code permits deductions from gross income for ordinary and necessary business expenses paid or incurred during the taxable year, including a reasonable allowance for salaries or other compensation for personal services actually rendered. 26 U.S.C. § 162. In the absence of § 404, employee pension plan contributions would constitute business expenses deductible under § 162. Section 404, however, displaces the more general provisions of § 162 and allows deductibility, within defined limits, of plan contributions provided the contributions are otherwise deductible. *See* 26 U.S.C. § 404(a). Although the excise tax of § 4975 discourages the contribution of non-cash property in satisfaction of a sponsor's funding obligation, it does not preclude the deductibility of these contributions under § 404 because a reasonable plan contribution, in whatever form, is a business expense and remains deductible as such.

The prohibited transaction provisions of § 4975 are part of a remedial scheme designed to protect the retirement security of plan participants and beneficiaries by prohibiting certain types of transactions which are particularly subject to abuse. We are therefore hesitant to construe these protective provisions narrowly. *See Leigh v. Engle*, 727 F.2d 113, 126 (7th Cir. 1984) (reading broadly the protective provisions of 29 U.S.C. § 1106 "in light of Congress' concern with the welfare of plan beneficiaries"). In addition, the very language of the section indicates that the term "sale or exchange" should not be interpreted restrictively because it applies to both direct and indirect transactions. *See* 26 U.S.C. § 4975(c).

Thus we conclude that when Wood, a concededly disqualified person, transferred non-cash property to the plan to satisfy his statutory funding obligation, he engaged in a "sale or exchange" under § 4975 and therefore is liable for excise taxes. The decision of the Tax Court dated November 16, 1990, is therefore

REVERSED.

APPENDIX D

UNITED STATES TAX COURT

DALLAS C. WOOD, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 322-89. Filed September 27, 1990.

COHEN, *Judge:* Respondent determined that petitioner is liable for excise taxes under section 4975(a) in the amount of $3,000 for 1984, $5,700 for 1985, and $5,700 for 1986. Respondent also determined that petitioner is liable for additions to tax under section 6651(a)(1) for failure to file excise tax returns, but respondent has now conceded the additions to tax.

The issue for decision is whether contribution of property to a defined benefit pension plan in order to satisfy the employer's funding obligation is a prohibited transaction, i.e., a "sale or exchange," within the meaning of section 4975(c)(1)(A).

Unless otherwise indicated, all section references are to the Internal Revenue Code as amended and in effect for the years in issue.

FINDINGS OF FACT

The material facts have been stipulated, and the stipulated facts are incorporated in our findings by this reference. Petitioner resided in Alexandria, Virginia, when he filed his petition in this case. During the years in issue, petitioner was a self-employed real estate broker.

In 1983, petitioner sold his principal residence. The buyers of the residence executed a deed of trust note in favor of petitioner for $60,000.

During 1984, petitioner was the real estate broker for the sale of two residential properties. The purchase agreement for each property provided, in part, that the purchasers would execute second trust deed notes in favor of the sellers. Petitioner subsequently purchased these notes, paying $32,000 for a note with a face value of $39,000 and $11,250 for a note with a face value of $15,000.

On October 16, 1984, petitioner adopted the Dallas C. Wood Defined Benefit Plan (the plan), effective January 1, 1984. Petitioner was the sole participant in the plan and served as the plan administrator and as the trustee.

The funding requirements of the plan were set forth in Article XIII as follows:

> *13.01* Benefits provided by this Plan and Trust shall be funded in accordance with the provisions of the Employee Retirement Income Security Act of 1974. The determination of contributions, shall be calculated using an accepted actuarial method. The calculations shall be performed by the actuary selected and approved by the Employer. The actuarial method utilized in funding this Plan and Trust shall be as provided and defined under

the Employee Retirement Income Security Act of 1974.

13.02 A funding standard account shall be maintained for this Plan and Trust. Each Plan Year the funding standard account shall be debited with the amount determined under Section 13.01 of this Plan and Trust and credited with the applicable contribution made for such Plan Year. The funding standard account will be credited or debited with such other amounts as may result from Plan and Trust changes, actuarial assumption changes, actuarial gains and losses, any approved deficiencies as provided under the Employee Retirement Income Security Act of 1974. If the debits under the funding standard account exceed the credits, a deficiency will exist. Such deficiencies will be subject to the provisions of the Employee Retirement Income Security Act of 1974.

The plan did not require that the plan be funded in cash and specifically allowed investment of trust funds in noncash assets.

Petitioner relied on Sal Corrao of Certified Actuarial Services, Inc., to establish, fund, and operate the plan. The aggregate level cost method was adopted as the valuation method used to calculate the cost of the plan benefits. Applying that method, the actuary calculated a cost of $114,000 as the required contribution for the year ended December 31, 1984.

In order to fund the plan, petitioner contributed the three third-party promissory notes previously acquired by him in the transactions described above. On his 1984 Federal income tax return, petitioner

claimed a deduction of $114,000, the combined face amounts of the three notes, for a contribution to the plan. The total fair market value of the three notes at the times that they were transferred to the plan was $94,430.

The three promisory notes were payable by third-party obligors who were unrelated to petitioner and were not "disqualified persons" within the meaning of section 4975. The principal of each note was paid prior to the date on which the note was due.

OPINION

Section 4975(a) and (b) imposes two levels of excise tax on any "disqualified person" who participates in a "prohibited transaction." There is no dispute in this case that petitioner is a disqualified person. See section 4975(e)(1) and (2). The parties disagree as to whether contributions of third-party promissory notes by petitioner to his Defined Benefit Pension Plan were prohibited transactions. The issue is not dependent on the nature of the promissory notes but may be generalized into the question of whether contribution by a disqualified person of property in satisfaction of the obligation to fund a defined benefit pension plan is a prohibited transaction.

Section 4975(c) defines prohibited transactions as follows:

SEC. 4975(c). PROHIBITED TRANSACTION.—

(1) GENERAL RULE.—For purposes of this section, the term "prohibited transaction" means any direct or indirect—

(A) sale or exchange, or leasing, of any property between a plan and a disqualified person;

(B) lending of money or other extension of credit between a plan and a disqualified person;

(C) furnishing of goods, services, or facilities between a plan and a disqualified person;

(D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;

(E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or

(F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

Section 4975(f) sets forth other definitions and special rules including the following:

(3) SALE OR EXCHANGE; ENCUMBERED PROPERTY.—A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

Respondent contends that petitioner's contribution of the notes to the plan should be treated as a sale

or exchange consistent with other areas of the Internal Revenue Code in which transfer of property in satisfaction of an indebtedness, in this case the obligation to fund the plan, is taxed as a sale or exchange. Respondent argues that transfer of property in satisfaction of an obligation to fund is distinguishable from a voluntary contribution. According to respondent, section 4975(f)(3), which appears to define sale or exchange in the context of prohibited transactions, is a special rule applicable to voluntary contributions.

Petitioner contends that the prohibited transaction provisions of section 4975 relate only to operations of a plan and that section 4975 has no application to contributions to a plan. Petitioner argues that other sections of the Code, imposing sanctions for failure to satisfy the minimum funding standards applicable to defined benefit plans, are intended to implement the standards applicable to contributions. Petitioner points out that there is no compelling reason why an employer cannot contribute property in satisfaction of a funding obligation. For the reasons and to the extent discussed below, we agree with petitioner.

In *Colorado National Bank of Denver v. Commissioner*, 30 T.C. 933 (1958), we specifically held that a transfer of land to a pension trust was payment to the trust within the meaning of section 404(a)(1)(C). We stated that "There is no reason why a contribution to a pension trust could not be made in property and still be deductible." 30 T.C. at 935. Respondent has not disputed this statement or argued that any legislation subsequent to our decision in *Colorado National Bank of Denver* changes that rule. Respondent has ignored that case, acknowledging, however, that "there is nothing in the

Code which precludes the deduction of a contribution in-kind (to the extent allowable under I.R.C. sec. 404) even though it may constitute a nonexempt prohibited transaction under sec. 4975." A different rule applies, of course, to contribution of a sponsoring employer's own notes. *Don E. Williams Co. v. Commissioner*, 429 U.S. 569 (1977).

Respondent argues that this case illustrates the potential for harm if transfer of property by an employer in satisfaction of an existing funding obligation is not a prohibited transaction. We agree with respondent that this case demonstrates potential for abuse. Petitioner, without any apparent cause, overstated the value of the property contributed to the plan. He had purchased two of the notes at a discount, and, in his business, he was well aware that the face value of the notes was not the fair market value of the notes. He admitted during his testimony at trial that he had not advised his actuarial consultant that he had purchased the notes at a discount. He failed to make the contribution that he claimed for deduction purposes, and he did not satisfy the funding requirements under the method calculated by his actuarial consultant.

Actual harm to a plan is not determinative of whether a transaction is prohibited within the meaning of section 4975. *Rutland v. Commissioner*, 89 T.C. 1137, 1146 (1987). Potential for abuse may be significant, however, if the legislative history and apparent purpose of a statute indicate that the statute was intended to prevent that specific abuse.

The statutory framework and legislative history of section 4975 indicate an intent to prohibit certain transactions without regard to actual abuse. In *Leib v. Commissioner*, 88 T.C. 1474 (1987), the taxpayer

contended that the section 4975(a) excise tax should not be imposed when a transaction would qualify as a prudent investment if judged under the highest fiduciary standards. Respondent argued that whether the prohibited transaction represented a prudent investment or benefited the plan was irrelevant. We agreed with respondent. We analyzed the express language and framework of the statute and the legislative history and concluded that Congress intended a blanket or unconditional prohibition against certain transactions, i.e., those listed in section 4975(c) and not exempted under section 4975(d).

The reasoning in *Leib*, however, indicates a result contrary to respondent's position in this case. If contributions of property are permitted under section 404, as we have held and respondent acknowledges, it is unlikely that Congress intended a blanket prohibition by taxation under section 4975.

Several applicable principles of statutory construction also suggest that a contribution of property to a defined benefit pension plan should not, per se, be deemed a prohibited transaction under section 4975 (c)(1)(A). First, all parts of a statute must be read together, and each part should be given its full effect. See, e.g., *Woods v. Commissioner*, 91 T.C. 88, 98 (1988). Thus, section 4975 must be read as part of the comprehensive provisions of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 88 Stat. 829. The excise tax provisions adopted under ERISA include, among other things, excise taxes on self-dealing by private foundations, section 4941, and the excise tax on failure to meet minimum funding standards set forth in section 4971.

Section 4941(d)(1) lists transactions that constitute "self-dealing" in terms indistinguishable from those prohibited transactions listed in section 4975(c).

Section 4941(d)(2)(A) is comparable to section 4975(f)(3) in specifying that a transfer of property shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien placed on the property by the disqualified person and assumed by the transferee. Respondent affirmatively asserts that sections 4941(d) and 4975(c) should be interpreted in a consistent manner and cites revenue rulings in which the Commissioner has taken the position that a transfer of property to a private foundation in cancellation of an indebtedness was a sale or exchange and an act of self-dealing under section 4941. Implicitly recognizing that contributions of property to a private foundation are not prohibited and are common, respondent argues that contributions in-kind that are purely voluntary are treated differently than contributions that discharge an existing obligation.

We agree that prohibited transactions for purposes of qualified pension plans are comparable to acts of self-dealing in relation to private foundations. Compare our discussion in *Leib v. Commissioner, supra*, with *Gershman Family Foundation v. Commissioner*, 83 T.C. 217, 225 (1984); see H. Conf. Rept. 93-1280, 1974-3 C.B. 415, 467 n.2; cf. *Lambos v. Commissioner*, 88 T.C. 1440, 1451-1452 (1987). Nothing in the provisions dealing with private foundations, however, persuades us that an unexpressed distinction between voluntary and required contributions should be read into the provisions dealing specifically with qualified pension plans.

Respondent also argues that the separate sanction for failure to satisfy funding standards set forth in section 4971 does not preclude application of both sanctions to the same set of circumstances. Citing *D.J. Lee, M.D., Inc. v. Commissioner*, 92 T.C. 291,

294-295 (1989), on appeal (6th Cir., May 3, 1989), respondent asserts that "[section 4971] was intended to deal with entirely different concerns than sec. 4975." That case applied section 4971 to an accumulated funding deficiency. It did not compare or discuss section 4975. In any event, if section 4975 was intended to deal with different concerns than section 4971, concerns about overvaluation of contributed property are not a justification for a blanket prohibition of contributions of property. (Other provisions, such as sections 6653(a) and 6661, apply to excessive deductions). Consideration of other provisions of ERISA, therefore, suggests that the scope of section 4975 should be confined to the plain meaning of its language.

All parts of section 4975 must also be read together and given effect. Petitioner argues that section 4975(f)(3) is rendered unnecessary and thus meaningless by respondent's interpretation that a contribution of property in satisfaction of a funding obligation is a sale or exchange. Respondent argues that the special definition of sale or exchange would still apply, but only to voluntary contributions. Respondent's interpretation would diminish the meaning of section 4975(f)(3) in a way not justified by any language in the statute. There is no indication in any part of ERISA that section 4975(f)(3) applies only to voluntary contributions or transfers and not to transfers in satisfaction of a funding obligation.

Petitioner's argument that section 4975 applies only to operations of a plan, not to contributions, is supported by the language in section 4975(c)(1)(A), (B), and (C), describing transactions *between* a disqualified person and a plan. Similarly, section 4975 (c)(1)(D) refers to transfers by a plan to a dis-

qualified person, and sections 4975(c)(1)(E) and (c)(1)(F) refer to acts by which a disqualified person who is a fiduciary deals with plan assets or receives consideration relating to transactions involving plan assets. All of these described transactions involve an act by a person who is acting on behalf of the plan as well as something done by the disqualified person on his or her own behalf. By their nature, these activities occur subsequent to funding of the plan and with respect to preexisting plan assets.

We cannot agree with petitioner, however, that none of the provisions of section 4975 applies to contributions. Section 4975(f)(3) specifically describes certain *transfers to* a plan by a disqualified person as a sale or exchange for purposes of section 4975. This language would include contributions to a plan.

Thus a second applicable principle of statutory construction is that, when Congress has dealt with a particular classification with specific language, the classification is removed from the application of general language. See *Energy Resources Ltd. v. Commissioner*, 91 T.C. 913, 916-917 (1988). In other words, detailed definitions of sale or exchange for purposes of the prohibited transaction rules should be applied in lieu of general definitions found in other areas of the tax law. See, e.g., *Essenfeld v. Commissioner*, 37 T.C. 117, 122-123 (1961), quoting *United States v. Chase*, 135 U.S. 255, 260 (1890).

The parties have stipulated that petitioner will be required to report, as capital gain, the difference between the face value of the notes and the amount of his purchase price for the notes. (The rationale of this result is unstated and unclear.) Although petitioner's transfer of the notes to the plan is a sale or exchange for purposes of recognition of income to him, it does not necessarily follow that the transfer

is a prohibited transaction under section 4975. With respect to transfers to a plan by a disqualified person, unaccompanied by affirmative acts on behalf of the plan, section 4975(f)(3) provides the definition of sale or exchange.

A third principle of statutory construction, i.e., that penalty provisions must be strictly construed, is also of assistance in interpreting section 4975. See *Commissioner v. Acker*, 361 U.S. 87, 91 (1959). Because its purpose as a blanket prohibition is to deter certain types of conduct, the excise tax imposed under section 4975(a) is in the nature of, and for some purposes is, a penalty provision. See *Nieto v. Ecker*, 845 F.2d 868, 874 n. 6 (9th Cir. 1988); cf. *Matter of Unified Control Systems*, 586 F.2d 1036, 1039 (5th Cir. 1978); compare *Latterman v. United States*, 872 F.2d 564, 568-570 (3d Cir. 1989).

Respondent assumes but does not concede that section 4975(a) imposes a penalty tax. He asserts:

> the issue in this case would still be whether there is "any expressed or necessarily implied provision or language . . ." (*Commissioner v. Acker*, 361 U.S. 87, 91 (1959)) which allows for the treatment of contributions in-kind as a prohibited transaction. And, in respondent's view, the "sale or exchange" language contained in sec. 4975(c)(1)(A) provides the necessary expression of congressional intent in this context. This is especially true in view of the fact that the statutory language itself manifests an intent that sec. 4975(c)(1) be given a broad reading. * * *

We cannot agree that the language of section 4975 provides the necessary expression (1) that contributions of property are subject to different standards than contributions of cash, or (2) that contributions

required under a plan are subject to different standards than voluntary contributions. These distinctions are basic, and the disputed transactions occur frequently enough that, we believe, Congress would have stated the distinctions if they were intended. Compare section 408(a)(1), requiring (with limited exceptions) that contributions to an Individual Retirement Account be in cash. See also section 401(a)(8), providing a special rule for forfeitures under a defined benefit plan. The provisions of ERISA as a whole are unusually detailed and specific. We decline to impose on section 4975(a) refinements that have not been specified by Congress.

We acknowledge that the interpretation given by the U.S. Department of Labor (DOL) to the parallel language in Title I of ERISA, section 406(a), is consistent with respondent's position in this case. See DOL Advisory Opinions 81-69A (July 28, 1981), and 90-05A (Mar. 29, 1990). The DOL has general interpretative authority under both Titles I and II of ERISA; consequently, the DOL's interpretation of the corresponding provisions under Title I is entitled to consideration in construing section 4975(c). In this case, however, we conclude that the language of the statute, interpreted in accordance with the principles stated above, must control. The language does not support the position of DOL or of respondent.

In summary, we conclude that nothing in ERISA changes prior law permitting transfers of property to a pension trust. We believe that, if such a change had been intended, Congress would have said so directly rather than by the imposition of a tax under section 4975.

For the foregoing reasons,

Decision will be entered for the petitioner.

APPENDIX E

INTERNAL REVENUE CODE (26 U.S.C.):

Section 404. Deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan

(a) General rule.—If contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under this chapter; but, if they would otherwise be deductible, they shall be deductible under this section, subject, however, to the following limitations as to the amounts deductible in any year:

* * * * *

(3) Stock bonus and profit-sharing trusts.—

(A) Limits on deductible contributions.—

(i) In general.—In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 501(a), in an amount not in excess of 15 percent of the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the stock bonus or profit-sharing plan.

Section 412. Minimum funding standards.

(a) General Rule.—Except as provided in subsection (h), this section applies to a plan if, for any plan year beginning on or after the effective date of this section for such plan—

(1) such plan included a trust which qualified (or was determined by the Secretary to have qualified) under section 401(a), or

(2) such plan satisfied (or was determined by the Secretary to have satisfied) the requirement of section 403(a).

A plan to which this section applies shall have satisfied the minimum funding standard for such plan for a plan year if as of the end of such plan year, the plan does not have an accumulated funding deficiency. For purposes of this section and section 4971, the term "accumulated funding deficiency" means for any plan the excess of the total charges to the funding standard account for all plan years (beginning with the first plan year to which this section applies) over the total credits to such account for such year or, if less, the excess of the total charges to the alternative minimum funding standard account for such plan years over the total credits to such account for such years. In any plan year in which a multiemployer plan is in reorganization, the accumulated funding deficiency of the plan shall be determined under section 428B.

* * * * *

Section 4941. Taxes on self-dealing

(a) Initial Taxes.

(1) On Self-Dealer.—There is hereby imposed a tax on each act of self-dealing between a dis-

qualified person and a private foundation. The rate of tax shall be equal to 5 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period. The tax imposed by this paragraph shall be paid by any disqualified person (other than a foundation manager acting only as such) who participates in the act of self-dealing. In the case of a government official (as defined in section 4946(c)), a tax shall be imposed by this paragraph only if such disqualified person participates in the act of self-dealing knowing that it is such an act.

* * * * *

(b) Additional taxes.—

(1) On self-dealer.—In any case in which an initial tax is imposed by subsection (a)(1) on an act of self-dealing by a disqualified person with a private foundation and the act is not corrected within the taxable period, there is hereby imposed a tax equal to 200 percent of the amount involved. The tax imposed by this paragraph shall be paid by any disqualified person (other than a foundation manager acting only as such) who participated in the act of self-dealing.

* * * * *

(d) Self-Dealing.—

(1) In General.—For purposes of this section, the term "self-dealing" means any direct or indirect—

(A) sale or exchange, or leasing, of property between a private foundation and a disqualified person;

* * * * *

(2) Special Rules.—For purposes of paragraph (1)—

(A) the transfer of real or personal property by a disqualified person to a private foundation shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the foundation assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer;

* * * * *

Section 4971. Taxes on failure to meet minimum funding standards

(a) Initial tax.—For each taxable year of an employer who maintains a plan to which section 412 applies, there is hereby imposed a tax of 10 percent (5 percent in the case of a multiemployer plan) on the amount of the accumulated funding deficiency under the plan, determined as of the end of the plan year ending with or within such taxable year.

(b) Additional tax.—In any case in which an initial tax is imposed by subsection (a) on an accumulated funding deficiency and such accumulated funding deficiency is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of such accumulated funding deficiency to the extent not corrected.

Section 4975. Tax on prohibited transactions

(a) *Initial Taxes on Disqualified Person.*—There is hereby imposed a tax on each prohibited transaction. The rate of tax shall be equal to 5 percent of the amount involved with respect to the prohibited

transaction for each year (or part thereof) in the taxable period. The tax imposed by this subsection shall be paid by any disqualified person who participates in the prohibited transaction (other than a fiduciary acting only as such).

(b) *Additional Taxes on Disqualified Person.*—In any case in which an initial tax is imposed by subsection (a) on a prohibited transaction and the transaction is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of the amount involved. The tax imposed by this subsection shall be paid by any disqualified person who participated in the prohibited transaction (other than a fiduciary acting only as such).

(c) *Prohibited Transaction.*—

* * * * *

(1) *General rule.*—For purposes of this section, the term "prohibited transaction" means any direct or indirect—

(A) sale or exchange, or leasing, of any property between a plan and a disqualified person;

(B) lending of money or other extension of credit between a plan and a disqualified person;

(C) furnishing of goods, services, or facilities between a plan and a disqualified person;

(D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;

(E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or

(F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

* * * * *

(e) *Definitions.*—

* * * * *

(2) *Disqualified person.*—For purposes of this section, the term "disqualified person" means a person who is—

(A) a fiduciary;

(B) a person providing services to the plan; [or]

(C) an employer any of whose employees are covered by the plan; * * *.

* * * * *

(f) *Other Definitions and Special Rules.*—For purposes of this section—

* * * * *

(3) *Sale or Exchange; Encumbered Property.*—A transfer [of] real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

Section 302 of ERISA, 29 U.S.C. 1082. Minimum funding standards

(a) Avoidance of accumulated funding deficiency

(1) Every employee pension benefit plan subject to this part shall satisfy the minimum funding standard (or the alternative minimum funding standard under section 1085 of this title) for any plan year to which this part applies. A plan to which this part applies shall have satisfied the minimum funding standard for such plan for a plan year if as of the end of such plan year the plan does not have an accumulated funding deficiency.

(2) For the purposes of this part, the term "accumulated funding deficiency" means for any plan the excess of the total charges to the funding standard account for all plan years (beginning with the first plan year to which this part applies) over the total credits to such account for such years or, if less, the excess of the total charges to the alternative minimum funding standard account for such plan years over the total credits to such account for such years.

* * * * *

Section 406 of ERISA, 29 U.S.C. 1106. Prohibited transactions

(a) Transactions between plan and party in interest

Except as provided in section 1108 of this title:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—

(A) sale or exchange, or leasing, of any property between the plan and a party in interest;

(B) lending of money or other extension of credit between the plan and a party in interest;

(C) furnishing of goods, services, or facilities between the plan and a party in interest;

(D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan; or

(E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 1107(a) of this title.

* * * * *

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No. 91-1677

In The

Supreme Court of the United States

October Term, 1991

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether Congress intended, when it enacted the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 *et seq.*, to prohibit employers from contributing any property other than cash to their defined benefit pension plans?

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RESPONDENT'S BRIEF IN OPPOSITION

STATEMENT OF THE CASE

The issue in this case is whether Congress intended, when it enacted the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1001 *et seq.*, to prohibit employers from contributing any property other than cash to their defined benefit pension plans. Petitioner argues that a contribution of noncash

property is a "prohibited transaction" because § 4975(c)(1)(A) of the Internal Revenue Code (the "Code"), 26 U.S.C. § 4975, prohibits any "sale or exchange" of property between a disqualified person (such as an employer) and a qualified pension plan. With no authority other than an analogy to income tax rules, petitioner argues that Congress intended for any contribution of noncash property to be treated as a "sale or exchange." Respondent acknowledges that there is a conflict on this issue between the decision of the United States Court of Appeals for the Fifth Circuit in the case at bar (reported at 951 F.2d 76 (CA5 1992), *aff'g*, 60 T.C.M. (CCH) 1423 (1990)), and the decision of the United States Court of Appeals for the Fourth Circuit in *Wood v. Commissioner* (reported at 955 F.2d 908 (CA4 1992), *rev'g*, 95 T.C. 364 (1990)).

The *Wood* and *Keystone* cases have progressed through the federal courts almost simultaneously. The Tax Court's decision in *Wood* was issued on September 27, 1990. In that decision, the Tax Court ruled that if Congress had intended to prohibit noncash contributions of property, it would have expressed that intention in plain language, rather than through an oblique reference to a "sale or exchange." Approximately two months later, on December 13, 1990, the Tax Court in *Keystone* issued a separate decision, granting Keystone's motion for summary judgment for reasons similar to those articulated in *Wood*.

The Commissioner appealed both decisions. Oral argument in *Wood* was held in the Fourth Circuit on October 1, 1991. Oral argument in *Keystone* was held in the Fifth Circuit on November 5, 1991. On January 17, 1991, the Fifth Circuit affirmed the Tax Court decision in *Keystone*, holding that Congress did not intend for a transfer of unencumbered property to be a prohibited "sale or exchange." Two weeks later, on January 31, 1991, the Fourth Circuit reversed the Tax Court decision in *Wood*, holding that the income tax definition of a "sale or exchange" should be applied

to the excise tax provisions enacted as part of ERISA, and that a contribution of property thus should be treated as a prohibited "sale or exchange."

REASONS FOR DENYING THE WRIT

Petitioner seeks a writ of certiorari so that this Court can resolve the conflict between the Court of Appeals for the Fourth and Fifth Circuits in *Wood* and *Keystone*. While there is a conflict between these two decisions, it would be imprudent at this time for this Court to resolve the conflict.

1. When Congress enacted § 4975 in 1974 as part of ERISA, authority to issue regulations under § 4975 rested with the Department of Treasury. Ths Department of Treasury never exercised its authority to issue or propose those regulations. In 1978, regulatory authority was transferred from the Department of Treasury to the Department of Labor (the "DOL"). Section 102 of Reorganization Plan No. 4 of 1978, 92 Stat. 3790. In the fourteen years since that transfer of authority, the DOL has not issued or proposed regulations.

Shortly before the transfer of authority to issue regulations under § 4975 to the DOL, an employer sought a private ruling from the Internal Revenue Service (the "IRS") that the contribution of a third-party promissory note from the employer to its defined benefit pension plan was not a prohibited transaction within the meaning of § 4975(c)(1). The IRS responded that the issue was *not* resolvable without regulations:

> [T]he question of whether the contribution of property other than cash by an employer to his plan constitutes a prohibited transaction as defined by section 4975(c)(1) of the Code, presents an issue that cannot reasonably be resolved prior to the

> issuance of regulations. Since regulations interpreting section 4975(c)(1) of the Code have not yet been promulgated, the Service is unable to issue a ruling as requested at the present time.

Private Letter Ruling 7852116 (Sept. 29, 1978).

Although regulations have never been issued or proposed, the Commissioner now asks this Court to resolve the question that the IRS previously asserted "cannot reasonably be resolved prior to the issuance of regulations." Respondent submits that it would not be a prudent use of this Court's resources to address an issue which might be resolved simply by the DOL's exercise of its regulatory authority.[1]

2. Respondent acknowledges that the decisions in the case at bar and in ***Wood v. Commissioner*** are in conflict. The facts under which this conflict arose, however, are unusual, and present less that compelling circumstances for this Court to resolve the conflict without further analysis from other courts of appeals.

Although § 4975 was enacted as part of ERISA in 1974, only recently did the IRS begin asserting that a contribution of property other than cash to a defined benefit pension plan was a prohibited transaction. As late as 1988, the Internal Revenue Manual, an

1. In an amicus brief, the Pension Benefit Guaranty Corporation (the "PBGC"), a corporation established within the DOL and whose Chairman of the Board is the Secretary of Labor, argues that contributions of noncash property should be prohibited in order to prevent valuation abuses. ***Keystone***, however, should not be asked retroactively to bear the burden of a penalty tax because the DOL failed, either from oversight or malaise, to issue regulations. Moreover, the PBGC fails to cite any authority or precedent that suggests Congress enacted § 4975 to address valuation abuses, and ignores the other excise tax provisions that impose penalties on employers who fail to fund their pension plans adequately. See, *e.g.*, § 4971 of the Code.

internal IRS handbook that is available to the public, stated that such a contribution was not a prohibited transaction unless the terms of the particular pension plan required cash contributions:

> Contributions are generally required to be made in cash. If the Plan requires that cash be contributed, then the contribution of property would constitute a sale or exchange, and hence a prohibited transaction. However, if the Plan permits a contribution to be made in cash or in kind, no prohibited transaction would occur.

Internal Revenue Service Manual, Examination Guidelines Handbook, H.B. 7(10)(54) § 320, 324(2) (July 15, 1988). Prior to the litigation in ***Wood*** and ***Keystone*** the IRS had many opportunities to litigate this issue but, for whatever reason, chose not to do so. ***See, e. g., Lambos v. Commissioner***, 88 T.C. 1440 (1987) (employer contributed property to a plan and then leased it back; Commissioner argued, and court agreed, that the leaseback, not the contribution, was a prohibited transaction); ***Busch v. Commissioner***, 45 T.C.M. (CCH) 772 (1983), ***aff'd***, 728 F.2d 945 (CA7 1984) (employer contributed noncash property to plan; Commissioner challenged deduction for the contribution under § 404 of the Code, but did not raise any issue under § 4975). Consequently, even though Section 4975 was enacted in 1974, the issue presented in this case is a relatively new one.

When the IRS finally decided that it should litigate this issue, the ***Wood*** case and the case at bar proceeded through the federal courts almost simultaneously. At the time of briefing and oral argument in ***Wood***, therefore, the Court of Appeals for the Fourth Circuit did not have the benefit of the Fifth Circuit's decision in ***Keystone***. Indeed, the decision in ***Wood*** was issued only two weeks after the decision in ***Keystone***, suggesting that much of the critical deliberation in ***Wood*** occurred before ***Keystone*** was

decided. Given these circumstances, where the cases creating the conflict are decided at almost exactly the same time, this Court will benefit from the views of other courts of appeals. Such review, in fact, might well eliminate any need for this Court to consider the issue.

3. Perhaps because *Keystone* had not been decided when *Wood* was briefed and argued, the Fourth Circuit in *Wood* committed several patent legal errors and/or oversights. These errors highlight why this Court should not hear this issue without additional input from other courts of appeals. For example:

a. Seeking to bolster its analysis by reference to administrative interpretations, the Fourth Circuit, citing Rev. Rul. 80-140, 1980-1 C.B. 89, stated that "the IRS has applied the generally accepted definition [of a "sale or exchange"] to the 'sale or exchange' language of § 4975 and has construed the transfer of property in satisfaction of a sponsor's statutory funding obligation as a sale or exchange." 955 F.2d at 913. This is incorrect. The issue in Rev. Rul. 80-140 was whether it was a prohibited transaction for an employer to contribute its own promissory note in satisfaction of a funding obligation. In this Court's decision in *Don E. Williams Co. v. Commissioner*, 429 U.S. 569 n.11 (1977), the Court had noted that it was a prohibited transaction under Code § 4975(c)(1)(B), *not* § 4975(c)(1)(A), for an employer to issue its own promissory note in satisfaction of a funding obligation. This Court's conclusion was based upon the language of § 4975(c)(1)(B), which prohibits any loans between a pension plan and an employer, and the legislative history of ERISA, where both the Senate and Conference Reports stated unambiguously that it would be a prohibited transaction under § 4975(c)(1)(B) for an employer to fund its obligations with its own promissory note. S. Rep. No. 383, 93d Cong., 1st Sess. 98 (1973); H.R. Conf. Rep. 1280, 93d Cong., 2d Sess. 308 (1974). The IRS cited *Don E. Williams* in Rev. Rul. 80-140, and said

nothing at all about a "sale or exchange" under § 4975(c)(1)(A).[2]

The court in *Wood* cited Rev. Rul. 80-140 on its own initiative — the Commissioner did not cite Rev. Rul. 80-140 in any of its briefs in *Wood* or *Keystone*, and the Commissioner did not cite it in its petition for certiorari here. As the Fifth Circuit correctly noted, the only place where the IRS has taken the position that an employer's contribution of property is a prohibited "sale or exchange" under § 4975(c)(1)(A) is here and in the *Wood* litigation. 951 F.2d at 79.

b. An employer's contribution of property to pension plan is a "sale or exchange" only if Congress intended to import the income tax definition of a "sale or exchange" into ERISA's prohibited transaction rules. In language of paramount importance to this case, § 4975(f)(3) of the Code amplifies § 4975(c)(1)(A) by stating that a transfer of property by an employer to a plan "shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien . . . ." As the Fifth Circuit and Tax Court correctly noted, § 4975(f)(3) demonstrates that Congress did not intend for a transfer of unencumbered property to be a prohibited "sale or exchange." The Fourth Circuit, however, thought that Congress enacted § 4975(f)(3) "to expand the definition of 'sale or exchange' as generally understood to include *all transfers* to a plan of *encumbered* property, whether or not in discharge of a debt . . . ." 955 F.2d at 913 (emphasis in original). The Fourth Circuit thus assumed that a transfer of property in satisfaction of a funding obligation is a "sale or exchange" under general income tax rules, but that a voluntary

2. If Congress viewed the transfer of noncash property to a plan as a prohibited "sale or exchange" under § 4975(c)(1)(A), Congress would not have said that a transfer of a promissory note was a prohibited transaction under § 4975(c)(1)(B). Nothing in the legislative history states that a transfer of noncash property would be a prohibited transaction under § 4975(c)(1)(A).

transfer is not a "sale or exchange" under those same rules.

The Fourth Circuit must have been unaware that *all* transfers of property from an employer to a plan, *whether voluntary or in satisfaction of a debt*, are treated as "sales or exchanges" under the income tax laws, and were so treated long before ERISA was enacted. *See, e.g., Tasty Baking Co. v. United States*, 393 F.2d 992, 995 (CtCl 1968); *A.P. Smith Mfg. Co. v. United States*, 364 F.2d 831, 838 (CtCl 1966), *cert. denied*, 385 U.S. 1003 (1967); *United States v. General Shoe Corp.*, 282 F.2d 9, 12 (CA6 1960), *cert. denied*, 365 U.S. 843 (1961); *International Freighting Corp. v. Commissioner*, 135 F.2d 310 (CA2 1943); Rev. Rul. 75-498, 1975-2 C.B. 29. Because voluntary transfers of property have been treated as "sales or exchanges" under the income tax laws for many years, the Fourth Circuit's conclusion that § 4975(f)(3) was intended to "expand" the income tax definition of a "sale or exchange" to voluntary transfers of mortgaged property makes no sense.[3] Voluntary transfers have always been within the so-called "income tax definition" of a "sale or exchange."

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3. The legislative history of ERISA expresses a concern that employers would disguise a "sale or exchange" by putting a mortgage on property and then contributing it to a pension plan:

> [A] transfer of property by a party in interest to a trust is treated as a sale or exchange if the property is subject to a mortgage or similar lien which the party in interest placed on the property within 10 years of the transfer to the trust, or if the trust assumes a mortgage or similar lien placed on the property prior to transfer. *This rule prevents circumvention of the prohibition on sale by mortgaging the property before a transfer to the trust.*

S. Rep. No. 383, 93d Cong., 1st Sess. 98 (1973) (emphasis supplied); *see also* H.R. Conf. Rep. 1280, 93d Cong., 2d Sess. 308 (1974). Section 4975(f)(3) was enacted to prevent this practice.

c. The Fourth Circuit's fundamental error was to fail to recognize that § 4975 was enacted in 1974 as part of ERISA, and was not enacted pursuant to an analysis or review of the income tax laws. Under the income tax laws, as the Fifth Circuit noted, transfers of property from an employer to a pension plan, both voluntary and involuntary, are treated as "sales or exchanges" in order to ensure that the employer's economic income is accurately measured. 951 F.2d at 79. Where the transferred property is subject to a mortgage, the amount of the mortgage is included in the transferor's "amount realized" from the "sale" and the transferee includes the amount of the mortgage in its basis. 26 C.F.R. § 1.1001-2(a)(1); *Commissioner v. Tufts*, 461 U.S. 300 (1983). For that reason, if Congress intended to incorporate the income tax definition of a "sale or exchange" into § 4975, § 4975(f)(3) is superfluous because a "voluntary" contribution of mortgaged property clearly is a "sale or exchange" under the income tax rules.

In contrast to the policy behind the income tax rules, Congress enacted § 4975 as part of ERISA to describe specific identifiable transactions that would be per se "prohibited" and subject to a penalty tax. If Congress had intended to prohibit noncash contributions when it enacted ERISA, the words "sale or exchange" are not the words it would have chosen. Congress would have used the words "contribution" or "transfer."[4]

Although petitioner asserts that there is only one "general" definition of a "sale or exchange," the words "sale or exchange" have many different meanings, depending on the statute at issue

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4. Compare § 4975(c)(1)(D), which makes it a prohibited transaction for a plan to "transfer" property to an employer, but imposes no prohibition on an employer "transferring" property to a plan. *See also* § 408(a)(1), which states, regarding individual retirement account contributions, that "no contribution will be accepted unless it is in cash."

and the legislative history of that statute. *Helvering v. Hammel*, 311 U.S. 504, 507 (1941). In *United States v. Davis*, 370 U.S. 65 (1962), this Court held that a *voluntary* transfer of property pursuant to a divorce agreement was to be treated as a "sale or exchange" for income tax purposes, even though the same transaction was *not* treated as a "sale or exchange" under the gift and estate tax statutes. The Court stated that "[i]n interpreting the particular income tax provisions here involved, we find ourselves unfettered by the language and considerations ingrained in the gift and estate tax statutes." 370 U.S. at 69 n.6. There is likewise no policy or analytical reason why the income tax definition of a "sale or exchange" should apply for purposes of ERISA, which is even less analogous to the income tax laws than are the estate and gift tax statutes.

CONCLUSION

For the reasons stated above, the Commissioner's petition for a writ of certiorari should be denied.

Respectfully submitted,

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(4)

No. 91-1677

In the Supreme Court of the United States

OCTOBER TERM, 1991

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY MEMORANDUM FOR THE PETITIONER

KENNETH W. STARR
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REPLY MEMORANDUM FOR THE PETITIONER

The question presented is whether an employer sponsoring a defined benefit pension plan may discharge its funding obligations by contributing property to the plan. In the government's view, such a contribution is a prohibited "sale or exchange" of property under 26 U.S.C. 4975(c)(1), which is part of the Employee Retirement Income Security Act of 1974 (ERISA). "Respondent acknowledges that there is a conflict on this issue between the decision of the United States Court of Appeals for the Fifth Circuit in the case at bar * * * and the decision of the United States Court of Appeals for the Fourth Circuit in *Wood* v. *Commissioner*." Br. in Opp. 2. And nothing in the response to our petition for a writ of certiorari disputes our contention that the question

presented involves a recurring issue of considerable importance.

Respondent nevertheless contends that "it would be imprudent at this time for this Court to resolve the conflict," Br. in Opp. 3, for three reasons. There is no merit to those contentions. First, respondent suggests that the issue "might be resolved simply by the [Department of Labor's] exercise of its regulatory authority." Br. in Opp. 4. The Department of Labor has indicated its view that the transfer of property in satisfaction of a funding obligation is a "sale or exchange" under ERISA's prohibited transaction provisions. DOL Advisory Opinion 90-05A (Mar. 29, 1990); DOL Advisory Opinion 81-69A (July 28, 1981). The Fifth Circuit has nonetheless rejected that view, on the basis of the court's conclusion as to the necessary effect of another subsection of the statute, 26 U.S.C. 4975(f)(3). See Pet. App. 5a, 7a. Because the court's holding is based on its interpretation of what the statute itself specifies, there is no reason to believe that adoption of a regulation would persuade the court to change its view.

Respondent next argues that review is unwarranted because the Fourth Circuit's decision in *Wood* upholding the government's position "was issued only two weeks after the decision" in this case. Br. in Opp. 5. But the Fourth Circuit was aware of the court's decision in this case. It stated that it found itself "in disagreement with the reasoning of the Fifth Circuit's decision" in this case, Pet. App. 28a, and devoted much of its opinion to explaining the basis for its disagreement. In that circumstance, there is no reason to think that the Fourth Circuit is likely to recede from its position in light of the Fifth Circuit's analysis in this case. To the contrary,

the Fourth Circuit had the benefit of the Fifth Circuit's opinion, and it expressly disagreed with it.*

Respondent's third point, in essence, is that the court in this case was so clearly right, and the Fourth Circuit in *Wood* was so clearly wrong, that review is not warranted. The linchpin of that argument is respondent's contention that the Fourth Circuit, in applying the generally recognized meaning of "sale or exchange" under the Internal Revenue Code in interpreting Section

* In the course of arguing that the conflict in the circuits is not "compelling" because *Wood* was issued shortly after the opinion in this case, Br. in Opp. 4, respondent notes that the 1988 version of IRS's Examination Guidelines Handbook stated that a contribution of property to a pension plan is not prohibited if the plan permits such contributions, *id.* at 5, citing Internal Revenue Service Manual, Examination Guidelines Handbook, H.B. 7(10)(54) §§ 320, 324(2) (July 15, 1988). In context, this statement is tempered by the example that follows, which states that employers may contribute stock to profit-sharing plans; such contributions are exempted from the prohibited transaction provisions by 29 U.S.C. 1107 and 1108. Furthermore, the Department of Labor, not IRS, has interpretive authority with respect to ERISA's prohibited transaction provisions. See Section 102 of Reorganization Plan No. 4 of 1978, 92 Stat. 3790. Moreover, the Handbook has been changed to advise IRS examiners that "even if the plan permits the contribution to be made in cash or in kind a prohibited transaction may still occur." Internal Revenue Service Manual, Examination Guidelines Handbook, H.B. 7(10)(54) §§ 320, 324.1(2) (Jan. 30, 1989). And in any event, as the Sixth Circuit stated with respect to the Handbook, "a guideline, adopted solely for the internal administration of the IRS, rather than for the protection of the taxpayer, does not confer any rights upon the taxpayer." *United States* v. *Will*, 671 F.2d 963, 967 (1982); see also *Schweiker* v. *Hansen*, 450 U.S. 785, 789 (1981) (the Social Security Administration's Claims Manual, "a 13-volume handbook for internal use by thousands of SSA employees," has "no legal force, and it does not bind the SSA").

4975(c)(1), "must have been unaware that *all* transfers of property from an employer to a plan, *whether voluntary or in satisfaction of a debt*, are treated as 'sales or exchanges' under the income tax laws." Br. in Opp. 8. According to respondent, that shows that Congress, by prohibiting contributions of encumbered property in 26 U.S.C. 4975(f)(3), did not expand the definition of "sale or exchange," as the Fourth Circuit concluded; that, in turn, fatally undermines the Fourth Circuit's construction of Section 4975(c)(1), in respondent's view, by rendering Section 4975(f)(3) superfluous.

Respondent overlooks the language of the statute. Section 4975(c)(1) prohibits a "sale or exchange * * * of any property between a plan and a disqualified person." A voluntary contribution of property to a defined contribution plan is not a "sale or exchange" between the plan and a disqualified person such as an employer. That is because, unlike the situation presented in this case and in *Wood*, where the contributions satisfied the employers' funding obligations to defined benefit plans, a voluntary contribution to a defined contribution plan is not made in exchange for anything from the plan. A voluntary contribution is a taxable event under the Internal Revenue Code because it constitutes an exchange between the employer and its employees. But Section 4975(c)(1) does not prohibit sales or exchanges between *employees* and employers, it prohibits sales or exchanges between *pension plans* and employers. Accordingly, the Fourth Circuit correctly concluded in *Wood* that Section 4975(f)(3) expands the scope of the prohibited transaction provision by barring voluntary contributions of encumbered property, and its holding in no way renders Section 4975(f)(3) superfluous.

For the foregoing reasons, as well as those stated in our petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

KENNETH W. STARR
Solicitor General

MAY 1992

(2)

No. 91-1677

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

COMMISSIONER OF INTERNAL REVENUE,
Petitioner

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.,
Respondent

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF FOR THE PENSION BENEFIT GUARANTY CORPORATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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BRIEF FOR THE PENSION BENEFIT GUARANTY CORPORATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

INTEREST OF AMICUS

The Pension Benefit Guaranty Corporation ("PBGC") is the federal government corporation charged by Congress with administering and enforcing Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA"), including the pension plan termination insurance program. *See* 29 U.S.C. §§ 1301-1461. The PBGC guarantees retirement benefits for more than 40 million Americans covered by defined benefit pension plans. *See gen-*

erally Nachman Corp. v. PBGC, 446 U.S. 359 (1980).[1] PBGC's guarantees are triggered when a defined benefit plan terminates without enough assets to pay vested benefits. The money to pay for those guarantees comes from the premiums assessed against all sponsors of PBGC-insured pension plans. Despite large increases in the premium rates since PBGC was created in 1974, PBGC's deficit has been growing and now stands at $2.5 billion. 1991 PBGC Annual Report at 1.

To keep the PBGC's deficit from ballooning further and to ensure the continued viability of this government insurance program, PBGC is vigilant about possible pension abuses. *See, e.g., PBGC v. LTV Corp.*, 496 U.S. 633 (1990). Because PBGC believes the Fifth Circuit's decision invites serious pension-funding abuse, we support the Solicitor General's petition on behalf of the Commissioner of Internal Revenue for a writ of certiorari to the Court of Appeals for the Fifth Circuit.[2]

[1] Defined benefit plans provide retirees a fixed amount per month based on factors such as final salary and years of service. Such plans differ from defined contribution plans (also known as individual account plans), under which employers typically contribute a percentage of an employee's compensation to an account, and the employee is entitled to the account upon retirement. *See* 29 U.S.C. § 1002(34) and (35).

[2] Rule 37.5 of the Rules of this Court authorizes the filing of a brief *amicus curiae*, without the consent of the parties, "on behalf of any agency of the United States authorized by law to appear on its own behalf when submitted by the agency's authorized legal representative." The PBGC has such legal authority, pursuant to 29 U.S.C. § 1302(b)(1), and has previously filed briefs as *amicus curiae* with the Court. *See, e.g., Mead Corp. v. Tilley*, 490 U.S. 714, 716 (1989); *Carpenters Pension Trust for Southern Cal. v. Shelter Framing Corp.*, 467 U.S. 1257 (1984).

REASONS FOR GRANTING THE WRIT

This case concerns whether a pension plan sponsor may make non-cash contributions to a defined benefit pension plan, in satisfaction of the sponsor's funding obligations, without violating the *per se* prohibited transaction rules. Those rules, contained both in ERISA and in the Internal Revenue Code, are explicit and were enacted to protect pension plan participants and beneficiaries from transactions thought to be highly susceptible to abuse. *See Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629, 636-637 (W.D. Wis. 1979); *Leib v. Commissioner*, 88 T.C. 1474, 1481 (1987). The Fifth Circuit upheld the Tax Court's holding that, under 26 U.S.C. § 4975(c), contributions of property, rather than cash, may be used to satisfy funding obligations due a defined benefit plan, without regard to the statutory protections governing "prohibited transactions." PBGC agrees with the Commissioner of Internal Revenue that the Fifth Circuit's holding is wrong. We believe the correct view is set forth in the Fourth Circuit's recent decision in *Wood v. Commissioner*, 955 F.2d 908 (4th Cir. 1992), which directly conflicts with the holding in the instant case.[3]

The Fifth Circuit's holding is contrary to the longstanding position of the Department of Labor expressed in its advisory opinions that a non-cash con-

[3] A petition for a writ of certiorari was filed in the *Wood* case on April 14, 1992. 60 U.S.L.W. 3745 (U.S. April 14, 1992) (No. 91-1645). As *Wood* raises the same issue as this case, PBGC urges the Court to consider the two cases together. The facts in *Wood* illustrate the potential for abuse even more clearly than the facts of this case. *See infra* at 8. The Fourth Circuit's decision in *Wood* should therefore be affirmed.

tribution of property to discharge a plan sponsor's legal obligation to make pension contributions is a prohibited transaction. Dep't of Lab. Advisory Op. 81-69A, 1981 ERISA LEXIS 24 (July 28, 1981); Dep't of Lab. Advisory Op. 90-05A, 1990 ERISA LEXIS 5 (March 29, 1990). And in allowing these kinds of contributions, the Fifth Circuit failed to consider the overall statutory scheme dealing with prohibited transactions. PBGC agrees, in particular, with the Fourth Circuit's comment in *Wood* that the prohibited transaction provisions of 26 U.S.C. § 4975 should not be construed narrowly because they are "part of a remedial scheme designed to protect the retirement security of plan participants and beneficiaries by prohibiting certain types of transactions which are particularly subject to abuse." 955 F.2d at 914.

The position taken by the Fourth Circuit in *Wood* does not absolutely bar non-cash contributions to a defined benefit pension plan.[4] Although such contributions would generally constitute prohibited transactions under 26 U.S.C. § 4975(c) and 29 U.S.C. § 1106(a), the parallel provision of ERISA, these statutes permit limited contributions of non-cash property if the transaction falls within a statutory exemption, *see* 26 U.S.C. § 4975(d); 29 U.S.C. § 1108, or if the contributing sponsor obtains an administrative exemption from the Department of Labor, *see* 26 U.S.C. § 4975(c)(2).[5] Section 1108(a) of Title 29 permits the Secretary of Labor to grant an exemption from the prohibited transaction rules if the exemption is (1) administratively feasible, (2) in the interests of the plan and of its participants and beneficiaries, and (3) protective of the rights of participants and beneficiaries of the plan. 29 U.S.C. § 1108(a).

In administering these provisions, the Department of Labor seeks to ensure, among other protective conditions, that the transaction is for "adequate consideration." *See, e.g.*, 29 C.F.R. § 2570.34(b)(5)(iii) (1991) (exemption applications must contain appraisals or market analyses); Grant of Individual Exemption: Pan American World Airways, Inc. Cooperative Retirement Income Plan, 54 Fed. Reg. 32,534, 32,536 (1989).[6] This, in turn, requires that the property be valued fairly, which protects participants and beneficiaries and, ultimately, PBGC's insurance program.

In the absence of these protections, allowing non-cash contributions in satisfaction of a plan sponsor's statutory funding obligation creates a tremendous potential for abuse. When non-cash contributions are made to a pension plan, the plan sponsor is generally the party valuing those contributions. And a plan sponsor, especially one experiencing financial difficulties, may have an incentive to inflate the value placed on contributed property. In PBGC's experience, the value placed on non-cash property at the time of con-

[4] Nor would it absolutely bar such contributions to a defined contribution plan. We focus on defined benefit plans, however, because they are the only kind of pension plans insured by PBGC and the kind at issue in the present case.

[5] The Department of Labor administers Title I of ERISA, containing 29 U.S.C. §§ 1106 and 1108, and also has primary authority to construe 26 U.S.C. § 4975. *See* Reorg. Plan No. 4 of 1978, 3 C.F.R. 332 (1978), *reprinted in* 5 U.S.C. app. at 1374 (1988), *and in* 92 Stat. 3790 (1978).

[6] Likewise, the statutory exemptions to the prohibited transaction rules require, *inter alia*, "adequate consideration." *See* 29 U.S.C. § 1108(e)(1).

tribution often exceeds the value realized on the property after the pension plan terminates and PBGC becomes plan trustee.

Contribution of overvalued non-cash property by a pension plan sponsor may disguise the fact that the sponsor is having trouble funding its plan. This is harmful in several ways. Not only are the required cash contributions not made, but because participants continue to accrue benefits, PBGC's possible losses increase as the pension plan becomes more underfunded. The statutory protections against underfunding (excise taxes, 26 U.S.C. § 4971, and funding suits, 29 U.S.C. § 1132(a)(5), (b)(1)) cannot be brought to bear and PBGC cannot make an informed decision about whether to terminate the plan.[7]

If in such a case the plan sponsor's business prospects do not improve, PBGC's potential losses become actual losses when the pension plan terminates. Moreover, because the level of benefits guaranteed by PBGC is limited, *see* 29 U.S.C. § 1322; 29 C.F.R. Part 2621 (1991), the participants and beneficiaries of the plan may suffer losess if the plan is underfunded due to a contribution of overvalued property.

Plan sponsors have generally complied with Department of Labor advisory opinions 81-69A and 90-05A; accordingly, the PBGC has not yet come across a large number of cases where non-cash contributions were made to defined benefit pension plans. However, in those cases where such contributions were made, the PBGC has often suffered substantial losses.

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[7] Section 1342(a) of Title 29 gives the PBGC authority to initiate plan termination in response to, *inter alia*, a failure to fund or to prevent the agency's potential losses from increasing unreasonably.

In one case, for example, a financially troubled plan sponsor contributed to its pension plans shares of its own non-marketable stock, in lieu of cash, to satisfy a $26 million funding obligation. The plan sponsor valued the stock at $26 million. When the plan sponsor subsequently filed for bankruptcy, it terminated its plans, which were underfunded by more than $550 million. PBGC thereafter filed suit against the plan trustee who accepted the stock at the inflated value, asserting, among other things, that the stock contribution was a prohibited transaction because it was not for "adequate consideration." As successor trustee of the by-then terminated pension plans, the agency sought to recover losses to the plans from this transaction of approximately $35 million (the estimated amount the plans lost on the improper transaction). And in pursuing the plan trustee, PBGC relied on the Department of Labor advisory opinions cited above that interpreted 29 U.S.C. § 1106, the ERISA parallel to 26 U.S.C. § 4975, to prohibit such non-cash contributions.

In the midst of settlement negotiations in that case, the Tax Court issued its opinion in *Wood*. 95 T.C. 364 (1990). The opinion was used against the PBGC because it rejected the rationale of the Department of Labor's advisory opinions and held that non-cash minimum funding contributions were not prohibited transactions. PBGC subsequently settled the case for $5 million, which it believed at the time, and still believes, was a reasonable settlement; however, the settlement covered only a small portion of PBGC's total loss from this transaction. Participants also lost $55 to $60 million of benefits not guaranteed by PBGC as a result of the plans' underfunding at termination.

In another recent termination, PBGC learned that the only contribution ever made to the pension plan of a now-bankrupt plan sponsor was a piece of real property. There are approximately $1.4 million in benefits due plan participants. Although the land was valued at $2 million by the plan sponsor at the time it was contributed in the early 1980's, it now has an estimated market value of only $350,000. While real estate market values have declined in the interim, it nonetheless appears that the original contribution was significantly overvalued. PBGC's funds must now be used to make up the plan's shortfall.

Finally, the *Wood* case, in which the Fourth Circuit held that a contribution of non-cash property was a prohibited transaction, provides further evidence of the potential for abuse. 955 F.2d 908, *petition for cert. filed*, 60 U.S.L.W. 3745 (U.S. April 14, 1992) (No. 91-1645). The minimum funding obligation for the year in question was $114,000. *Id.* at 909. Rather than contribute that amount in cash, the plan sponsor contributed promissory notes with a face value of $114,000. *Id.* The market value of the notes, however, was only $94,430. *Id.* at 910. The plan therefore actually received $20,000 less than required by the minimum funding rules.

These examples illustrate how non-cash contributions to a defined benefit pension plan can harm the participants, the plan and the PBGC. Because the potential for abuse is so great when non-cash property is used to satisfy funding obligations, PBGC strongly supports a blanket prohibition on such transactions, unless the contribution satisfies a statutory exemption or the plan sponsor obtains an administrative exemption from the Department of Labor permitting such a contribution. PBGC believes that this is what

Congress intended when it enacted the prohibited transaction provisions.

CONCLUSION

The petition for a writ of certiorari should be granted.

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No. 91-1677

In the Supreme Court of the United States

OCTOBER TERM, 1992

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF FOR THE PETITIONER

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QUESTION PRESENTED

Whether the contribution of property to a defined benefit pension plan by the plan's sponsoring employer, in satisfaction of the employer's funding obligation, constitutes a prohibited "sale or exchange" of the property under 26 U.S.C. 4975.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-9a) is reported at 951 F.2d 76. The memorandum opinion of the United States Tax Court (Pet. App. 10a-17a) is reported at 60 T.C.M. (CCH) 1423.

JURISDICTION

The judgment of the court of appeals was entered on January 17, 1992. The petition for a writ of certiorari was filed on April 16, 1992, and was granted on October 5, 1992. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTES INVOLVED

Sections 404, 412, 4941, 4971, and 4975 of the Internal Revenue Code (26 U.S.C.) and Sections 302 and 406 of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1082 and 1106, are set forth, in pertinent part, at Pet. App. 45a-52a.

STATEMENT

1. During its taxable years ending June 30, 1983, through June 30, 1988, respondent Keystone Consolidated Industries, Inc., maintained several tax-qualified defined benefit pension plans.[1] The plans were subject to the funding requirements of Section 302 of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1082. See also 26 U.S.C. 412. Respondent funded the pension plans through contributions to the Keystone Consolidated Master Pension Trust. Pet. App. 2a.

On March 8, 1983, respondent contributed five truck terminals with a fair market value of $9,655,454 to the Pension Trust.[2] Respondent credited the fair market value of the truck terminals against its statutory funding obligation to its employees' defined benefit pension plans for its taxable years ending June 30, 1982, and June 30, 1983. In addition, on March 13, 1984, respondent contributed to the Pension Trust real property in Key West, Florida, having a fair market value of $5,336,751. Respondent credited the fair market value of the Key West property against its statutory funding obligation to the Pension Trust for the taxable year ending June 30, 1984. Neither the truck terminals nor the Key West property was encumbered by a mortgage. Pet. App. 11a-12a.

Respondent claimed deductions on its federal income tax returns under 26 U.S.C. 404 in the amount of the fair market value of the five truck terminals and the Key West property. Respondent also reported the difference between its basis in each property and the fair market value of the property as capital gain. Thus, for income tax purposes respondent treated the dispositions of the properties as "sale[s] or exchange[s]" of a capital asset. Pet. App. 12a; see 26 U.S.C. 1222.

Section 4975 of the Internal Revenue Code, which was added to Title 26 by ERISA, imposes a two-tier excise tax on specified "prohibited transactions" between a pension plan and a "disqualified person."[3] Among the

[1] A defined *benefit* pension plan is a plan under which retirees receive a fixed amount per month, which is typically based on factors such as the retiree's prior salary and years of service. Such plans differ from defined *contribution* pension plans (such as profit sharing plans and stock bonus plans), under which employers typically contribute a percentage of their payroll or profits to individual accounts; employees participating in defined contribution plans are entitled to the amount in their individual accounts upon retirement. See 29 U.S.C. 1002(34) and (35). If either sort of plan qualifies for favorable tax treatment, the employer may deduct its contributions to the plan immediately, but the plan participants are not taxed until they receive distributions from the plan. See 26 U.S.C. 402(a)(1), 404(a)(1).

[2] Respondent had acquired the five truck terminals from a subsidiary of its principal shareholder. According to respondent's 1983 annual report, its long-range plan at the time it acquired the terminals was to dispose of them. Affidavit of James S. Stanis, Exh. A at 50-51. Two of the terminals were subject to exclusive listing agreements, calling for the payment of sales commissions of at least five percent, when respondent contributed them to the Pension Trust. *Id.*, Exhs. E.3, E.4.

[3] The first tier of the excise tax is five percent of the "amount involved," 26 U.S.C. 4975(a), while the second-tier is 100% of the "amount involved," 26 U.S.C. 4975(b). The "amount involved" is the greater of the fair market value of the property as given or

"disqualified person[s]" listed in the statute is the employer of the employees covered by a pension plan. 26 U.S.C. 4975(e)(2)(C). Among the transactions prohibited by Section 4975 is "any direct or indirect * * * sale or exchange * * * of any property between a plan and a disqualified person." 26 U.S.C. 4975(c)(1)(A). The Commissioner of Internal Revenue determined that respondent's transfers to the Pension Trust of the five truck terminals and the Key West property constituted prohibited "sale[s] or exchange[s]" of those properties under Section 4975(c)(1)(A), so that respondent was subject to the excise tax.[4] Respondent filed a petition in the Tax Court for a redetermination of its liability.

2. The Tax Court held in favor of respondent. It acknowledged that "there is a potential for abuse by allowing unencumbered property transfers to plans in satisfaction of minimum funding requirements." Pet. App. 14a. For example, such property may be overvalued. In addition, "the employer can save costs related to the sale of the asset by transferring it into a plan, rather than selling it outright." *Id.* at 15a. And the court recognized that the transfers of the properties constituted taxable events for income tax purposes. *Id.* at 14a. The court

received. 26 U.S.C. 4975(f)(4). The second tier tax ordinarily may be avoided by timely correction of the prohibited transaction upon completion of the litigation concerning the taxpayer's liability for that tax. See 26 U.S.C. 4961(a), 4963(b) and (e), 6213(a), 7481(a).

[4] The Commissioner determined deficiencies in respondent's first tier excise tax liability of $749,610 for its taxable year ending June 30, 1984, and of $482,773 for each of the taxable years ending June 30, 1983, and June 30, 1985, through June 30, 1988. The Commissioner also determined a deficiency in respondent's second tier excise tax liability for its taxable year ending June 30, 1988, in the amount of $9,655,454. Pet. App. 12a.

nevertheless concluded that the transfers were not "sale[s] or exchange[s]" under Section 4975(c)(1)(A), the provision prohibiting "any direct or indirect * * * sale or exchange * * * between a plan and a disqualified person."

In so holding, the court relied on 26 U.S.C. 4975(f)(3). That provision states that a transfer of property "by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien." In the Tax Court's view, "[s]ince section 4975(f)(3) specifically describes certain transfers of real or personal property to a plan by a disqualified person as a sale or exchange for purposes of section 4975, the definitional concerns of 'sale or exchange' are removed from the general definitions found in other areas of the tax law." Pet. App. 15a. Thus, the court held that Section 4975(f)(3) *limits* the reach of Section 4975(c)(1)(A), so that only transfers of encumbered property are prohibited, and accordingly rejected the Commissioner's argument that Section 4975(f)(3) *expands* the reach of the prohibited transaction rules. In the Commissioner's view, Section 4975(c)(1)(A) prohibits employers from contributing property rather than cash to fulfill their funding obligations to pension plans, while Section 4975(f)(3) additionally prohibits contributions of encumbered property to pension plans even if the contribution does not satisfy an obligation the employer owes the plan. Pet. App. 16a.[5]

The Tax Court further disagreed with the Commissioner's argument that by contributing property rather

[5] Contributions that do not fulfill funding obligations may occur in connection with defined contribution pension plans. See, *e.g.*, DOL Advisory Opinion 90-05A (Mar. 29, 1990) (App., *infra*, 4a-9a).

than cash to a plan, the employer can exert an unwarranted influence over the trust's investment policy. "If the asset is truly a poor investment," the court said, "the trustee, acting under its fiduciary capacity, can dispose of it." Pet. App. 15a. The court also noted that the Commissioner's distinction between transfers of property in satisfaction of a funding obligation (which are prohibited by Section 4975(c)(1)(A), in the Commissioner's view) and transfers of encumbered property (which are prohibited by Section 4975(f)(3), in the Commissioner's view, whether or not the contribution fulfills a funding obligation) had been rejected by the Tax Court in *Wood* v. *Commissioner*, 95 T.C. 364 (1990), rev'd, 955 F.2d 908 (4th Cir.), cert. granted, 112 S. Ct. 2937, cert. dismissed, 112 S. Ct. 3061 (1992); see Pet. App. 32a-44a.

3. The Fifth Circuit affirmed. Pet. App. 1a-9a. It read Section 4975(f)(3) as "implying that unless it is encumbered by a mortgage or lien, a transfer of property is not to be treated as if it were a sale or exchange." Pet. App. 5a. With respect to the Commissioner's argument that Section 4975(f)(3) was intended to expand the definition of "sale or exchange" to include transfers of encumbered property that do not fulfill funding obligations (*i.e.*, "voluntary" contributions), the court responded that, in its view, there is "no basis for this distinction between involuntary and voluntary transfers anywhere in the Code." Pet. App. 6a.[6]

[6] The court added that, in its opinion, the Commissioner's "distinction also makes no economic sense," because "when an employer makes a voluntary contribution to a plan, he effectively supplements the assets of the plan, receives a credit in his funding standard account, and thereby reduces the amount of mandatory contributions in future years." Pet. App. 6a. Those comments, while relevant to defined benefit pension plans, are inapplicable to defined contribution plans that do not mandate employer contributions; they are also inapplicable to contributions to defined contribution plans in excess of any mandatory amount. See pages 24-25, *infra*. The court also stated that "[i]f all transfers of property to a plan were to be treated as a sale or exchange" under Section 4975(c)(1)(A), then Section 4975(f)(3) "would be superfluous." Pet. App. 5a. That comment likewise ignores the existence of defined contribution pension plans. See pages 24-25, *infra*.

The court of appeals also stated that the potential for abuse posed by transfers of property in satisfaction of funding obligations is "already restrained" by the excise tax on accumulated funding deficiencies set out in 26 U.S.C. 4971. Pet. App. 8a. Moreover, it is "irrelevant," the court stated, that a transfer of property in satisfaction of an obligation is treated as a "sale or exchange" of property for income tax purposes, because Section 4975 "was not enacted to measure economic income." Pet. App. 7a.

Noting that both the IRS and the Department of Labor administer ERISA's prohibited transaction provisions,[7] the court acknowledged that both agencies "have found that similar transfers of property to pension funds were sales or exchanges under other sections of the Code and ERISA." Pet. App. 7a. But the court ruled that the Commissioner's views "are not entitled to any defer-

[7] A provision that is parallel to 26 U.S.C. 4975(c)(1)(A) was added to Title 29 by Section 406 of ERISA. That parallel provision prohibits a fiduciary from engaging in "a direct or indirect * * * sale or exchange * * * of any property between the plan and a party in interest." 29 U.S.C. 1106. The Department of Labor enforces the fiduciary duty provision, just as the IRS enforces Section 4975. Under the administrative division of responsibility, the Department of Labor has primary authority to construe both 26 U.S.C. 4975 and 29 U.S.C. 1106. See Reorg. Plan No. 4 of 1978, § 102, 92 Stat. 3790.

ence" because they had not been set out in a regulation. *Id.* at 8a. The court declined to defer to the Department of Labor either, because the Department's conclusion that transfers of property in satisfaction of funding obligations are prohibited was set out in an advisory opinion that was "binding only on the parties thereto." *Ibid.*[8]

SUMMARY OF ARGUMENT

A. The court of appeals misinterpreted 26 U.S.C. 4975. Like the parallel "prohibited transaction" provision enacted in Section 406(a)(1)(A) of ERISA, 29 U.S.C. 1106(a)(1)(A), Section 4975(c)(1)(A) broadly bars any "direct or indirect * * * sale or exchange" of property between a pension plan and a disqualified person such as respondent. For more than fifty years the courts have held that the transfer of property in satisfaction of a monetary obligation, as occurred in this case, constitutes a "sale or exchange" of the property under the income tax laws. It is appropriate to turn first to the settled meaning of the phrase "sale or exchange," and it makes sense to apply that interpretation in this case. By contributing the truck terminals and the Key West property in partial satisfaction of its funding obligation, respondent effectively sold the properties to the Pension Trust and applied the proceeds to its debt. Moreover, Congress drafted Section 4975(c)(1)(A) broadly, barring "any direct or indirect * * * sale or exchange," and it

[8] The Commissioner also appealed the Tax Court's decision in *Wood* v. *Commissioner, supra,* to the Fourth Circuit. That court reversed, stating that it "found itself in disagreement with the reasoning of the Fifth Circuit's decision" in this case. Pet. App. 28a.

surely intended that expansive language to apply in cases like this one.

A properly broad, literal construction of Section 4975(c)(1)(A) and Section 406 serves three important purposes. First, it prevents the overvaluation of contributed property from going undetected. Second, it prevents employers from transferring sales costs to the pension plans they sponsor. Third, a contrary construction of the prohibited transaction provisions would allow employers to circumscribe the trustees' discretion as to how the assets of a pension plan are to be invested.

The court of appeals reasoned that such problems were solved by 26 U.S.C. 4971, which imposes an excise tax on employers whose plans are underfunded. Pet. App. 8a. But Section 4975 serves the related, but different purpose of preventing plans from incurring losses on account of particular types of transactions that have a high potential for abuse. Moreover, if an underfunded plan is terminated while holding overvalued property or property that is difficult to sell, Section 4971 is of no use to the Pension Benefit Guaranty Corporation (PBGC), which will have to convert the property to cash. And participants and beneficiaries may be harmed if a terminated plan is holding troublesome property, because the PBGC does not insure 100% of pension benefits.

B. The court of appeals construed Section 4975(c)(1)(A) contrary to its broad language and the settled meaning of "sale or exchange" primarily because it thought that a narrow construction was mandated by Section 4975(f)(3). But Section 4975(f)(3) sets forth a special rule—providing that "[a] transfer [of] real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien"—that *broadens* the scope of

the prohibited transaction rules. Section 4975(f)(3) does not purport to give "sale or exchange" a narrow meaning, but instead provides that any contribution of encumbered property "shall be treated as" a sale or exchange.

The basis for the court's error was its failure to understand that employers may transfer property to defined *contribution* pension plans (see note 1, *supra*) in certain circumstances. The Department of Labor, which has primary responsibility for construing the parallel prohibited transaction provisions, has concluded that the transfer of unencumbered property to a defined contribution plan is not prohibited if the transfer is in addition to a cash payment satisfying the employer's obligation to the plan. DOL Advisory Opinion 90-05A (Mar. 29, 1990) (App., *infra*, 4a-9a). Therefore, contrary to the court of appeals' reasoning (Pet. App. 5a), a holding that Section 4975(c)(1)(A) prohibits contributions of property in satisfaction of funding obligations does not render Section 4975(f)(3) superfluous. Rather, Section 4975(f)(3) bars employers from contributing mortgaged property to pension plans, whether or not the contribution satisfies an obligation.

Respondent makes a slightly different argument to the effect that the government's construction of Section 4975(c)(1)(A) renders Section 4975(f)(3) superfluous (Br. in Opp. 8), and its argument is also erroneous. Respondent correctly notes that, under the applicable income tax rules, an employer generally must recognize gain upon making a contribution of property to a pension plan. Respondent goes on to argue that if "sale or exchange" is given meaning in Section 4975(c)(1)(A) by reference to the income tax rules, all transfers of property by employers to pension plans are prohibited by that provision. But Section 4975(c)(1)(A) prohibits transactions that are

sales or exchanges of property "between a *plan* and a disqualified person" (emphasis added). A transfer of property that does not satisfy a funding obligation is not such a transaction, and hence is not barred by Section 4975(c)(1)(A). The employer's gain on such a transaction is subject to tax under the income tax provisions because a voluntary transfer of property to a pension plan is a "sale or exchange" between the employer and *its employees*, not a pension plan.

Moreover, the government's construction of Section 4975 is sensible, while respondent's construction is not. In the government's view, Section 4975 prohibits transfers of property in satisfaction of an employer's funding obligations, transactions that are likely to be abusive, and also prevents *any* transfer of mortgaged property, which can burden pension plans. But in respondent's view, the prohibited transaction provisions allow transfers of property in satisfaction of funding obligations despite their high potential for abuse. It is hard to believe that Congress wanted to protect pension plans from dealing with mortgaged property, even if the contribution of the mortgaged property was in addition to the employer's satisfaction of its funding obligation, while allowing employers to discharge their funding obligations by contributing property to their pension plans.

C. In 1981, the Department of Labor concluded, in an opinion letter issued in a case similar in all pertinent respects to this case, that employers may not discharge their funding obligations by contributing property to pension plans. DOL Advisory Opinion 81-69A (July 28, 1981) (App., *infra*, 1a-3a). The other agencies that administer ERISA (the IRS and the PBGC) agree with the Department of Labor's construction of the prohibited transaction provisions. The government's construction

of Section 4975 is at least permissible (in our view, it is the most natural reading of the statute), and the government's interpretation of the statute is therefore entitled to deference.

ARGUMENT

THE CONTRIBUTION OF PROPERTY TO A DEFINED BENEFIT PENSION PLAN BY THE PLAN'S SPONSORING EMPLOYER, IN SATISFACTION OF THE EMPLOYER'S FUNDING OBLIGATION, CONSTITUTES A PROHIBITED "SALE OR EXCHANGE" OF THE PROPERTY UNDER 26 U.S.C. 4975(c)(1)(A)

Prior to the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829, the "arm's-length" standard of conduct governed transactions between pension plans and their sponsors. S. Rep. No. 383, 93d Cong., 1st Sess. 32 (1973). The arm's-length standard, however, "require[d] substantial enforcement efforts, resulting in sporadic and uncertain effectiveness." *Ibid.* Accordingly, employers sometimes were able to sell property to the pension plans they sponsored at inflated prices; alternatively, employers sometimes could satisfy their obligations to the pension plans they sponsored by contributing property that was overvalued or illiquid and depreciating. Such abuses put pension benefits at risk.

Congress responded to this problem in a number of ways. Most relevant to this case are the two parallel provisions Congress enacted in ERISA that replaced the arm's-length standard with a *categorical* rule barring employers from contributing property to pension plans instead of making required contributions in cash. See *Donovan v. Cunningham*, 716 F.2d 1455, 1464-1465 (5th Cir. 1983), cert. denied, 467 U.S. 1251 (1984) (the object of

the prohibited transaction provisions "was to make illegal per se the types of transactions that experience had shown to entail a high potential for abuse"). One of those provisions, Section 406(a)(1)(A) of ERISA, 29 U.S.C. 1106(a)(1)(A), prohibits the fiduciaries of employee benefit plans from engaging in any transaction that "constitutes a direct or indirect * * * sale or exchange * * * of any property" between the plan and its sponsoring employer.[9] In addition to remedies available against fiduciaries who violate Section 406 of ERISA, Congress also added Section 4975, the provision directly at issue in this case, to the Internal Revenue Code. Section 4975(c)(1)(A) imposes a heavy, two-tier tax (see note 3, *supra*) on employers who engage in "any direct or indirect * * * sale or exchange * * * of any property" with a pension plan they sponsor.

The court of appeals failed to construe Section 4975(c)(1)(A) in accordance with its broad language and the settled meaning of "sale or exchange," and instead eviscerated the provision. Focusing on Section 4975(f)(3)—which provides that a transfer of property to a plan "shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien"—the court limited the reach of Section 4975 to encumbered property. But Section 4975(f)(3) was intended to *broaden* the reach of the prohibited transaction provision to bar any contribution of mortgaged property, even if the contribution did not fulfill a funding obligation. Section 4975(f)(3) does not purport, and was not intended, to allow employ-

[9] Section 406 prohibits sales or exchanges with welfare plans as well as pension plans. For example, it prohibits the fiduciaries of collectively-bargained health plans, as well as the fiduciaries of pension plans, from accepting contributions of property instead of cash.

ers to sell property to pension plans by contributing unencumbered property, rather than cash, to satisfy their funding obligations.

A. The Contributions At Issue Were "Sale[s] Or Exchange[s]" Because They Satisfied Respondent's Funding Obligations

1. Section 4975(c)(1)(A) broadly prohibits "any direct or indirect * * * sale or exchange * * * of any property" between a pension plan and its sponsoring employer. It is well established under the Internal Revenue Code that the transfer of property in satisfaction of a monetary obligation, as occurred in this case when respondent transferred the truck terminals and the Key West property to the Pension Trust to satisfy its funding obligation, generally constitutes a "sale or exchange" of the property. See, *e.g.*, *Helvering* v. *Hammel*, 311 U.S. 504 (1941); *Laport* v. *Commissioner*, 671 F.2d 1028, 1033 (7th Cir. 1982); *Stamler* v. *Commissioner*, 145 F.2d 37, 39 (3d Cir. 1944); *Lakeside Irr. Co.* v. *Commissioner*, 128 F.2d 418, 419 (5th Cir.), cert. denied, 317 U.S. 666 (1942); *Burger-Phillips Co.* v. *Commissioner*, 126 F.2d 934, 935 (5th Cir. 1942); *Larus* v. *Commissioner*, 123 F.2d 254, 255 (2d Cir. 1941); *Pender* v. *Commissioner*, 110 F.2d 477, 478 (4th Cir.), cert. denied, 310 U.S. 650 (1940). Cf. *Commissioner* v. *Tufts*, 461 U.S. 300 (1983); *Crane* v. *Commissioner*, 331 U.S. 1 (1947). Similarly, the courts have held that a transfer of property to satisfy a bequest that was stated in dollar terms, a transaction not unlike a transfer of property in satisfaction of a funding obligation, is a "sale or exchange" of the property transferred. See *Kenan* v. *Commissioner*, 114 F.2d 217, 219-220 (2d Cir. 1940); *Brinckerhoff* v. *Commissioner*, 8 T.C.

1045, 1049 (1947), aff'd, 168 F.2d 436 (2d Cir. 1948). Accord, Rev. Rul. 67-74, 1967-1 C.B. 194.

The logic supporting the conclusion that a transfer of property in satisfaction of an obligation is a "sale or exchange" is straightforward: "When property is transferred in satisfaction of a debt, the transaction is functionally equivalent to a sale of the property for cash, coupled with a use of the proceeds to pay the debt." 2 B. Bittker, *Federal Taxation of Income, Estates and Gifts* para. 40.4, at 40-11 (1990); cf. *Pender* v. *Commissioner*, 110 F.2d at 478; *Burger-Phillips Co.* v. *Commissioner*, 126 F.2d at 936; *Kenan* v. *Commissioner*, 114 F.2d at 219; *Commissioner* v. *S.A. Woods Mach. Co.*, 57 F.2d 635, 636 (1st Cir.), cert. denied, 287 U.S. 613 (1932); *Rogers* v. *Commissioner*, 103 F.2d 790, 792-793 (9th Cir.), cert. denied, 308 U.S. 580 (1939); see also *Schultz* v. *Commissioner*, 59 T.C. 559, 565 (1973); S. Surrey, P. McDaniel, H. Ault & S. Koppelman, *Federal Income Taxation* 928 (Successor ed. 1986). Thus, respondent's contribution of the truck terminals and the Key West property amounted to a sale of the properties to the Pension Trust, with the proceeds used to satisfy respondent's funding obligation.[10]

[10] The transactions differed from sales to third parties, with the proceeds used to satisfy respondent's funding obligation, in three ways, each of which illustrates why Congress prohibited transfers of property by employers to pension plans. First, if an employer sells property to a third party and uses the proceeds to satisfy its funding obligation, there is no question concerning the value of the employer's contribution to the plan, since the contribution would be made in cash. But when property is transferred to a pension plan, so that there is no actual sale on an open market, there may be considerable doubt as to the actual value of the contribution. Second, if an employer sells property to a third party, the employer bears the transaction costs of the sale. By transferring

Accordingly, by transferring its truck terminals and the Key West property to the Pension Trust in satisfaction of its funding obligation, respondent effectively accomplished precisely what Section 4975(c)(1)(A) prohibits—selling those properties to the Pension Trust. Indeed, neither respondent nor the court of appeals has contended that the contribution of property to a pension plan in satisfaction of a debt is not a "sale or exchange" under the ordinary meaning of that phrase. And in *Wood*, the Fourth Circuit, which refused to depart from the well-settled rule in the tax law that a transfer of property in satisfaction of an obligation is a "sale or exchange," observed that it was "aware of no instance when the term 'sale or exchange' has been used or interpreted not to include transfers of property in satisfaction of indebtedness." Pet. App. 28a.

Contrary to the view of the court of appeals in this case, the judicial decisions construing "sale or exchange" are not "irrelevant" (Pet. App. 7a) because they arose under the income tax provisions of the Internal Revenue Code. To the contrary, the rationale of those decisions—that a transfer of property in fulfillment of a dollar obligation is a type of sale—is entirely applicable under Section 4975(c)(1)(A). Indeed, the phrase "sale or exchange" had acquired a settled judicial and administrative interpretation over the course of more than 50

property to the plan, an employer also transfers the transaction costs of disposing of the property. Third, if an employer contributes cash to a pension plan, the trustees of the plan may invest it as they consider most appropriate. But if property is contributed instead of cash, then the plan has been forced to invest in that property until the trustees liquidate the property and reinvest the proceeds, and the plan bears the risk of depreciation until the property is liquidated.

years before Congress enacted the even broader statutory language—embracing "*any* direct *or indirect* * * * sale or exchange"—in Section 4975 (emphasis added). Cf. *McWilliams* v. *Commissioner*, 331 U.S. 694 (1947). Congress was presumptively aware when it enacted Section 4975 that the phrase "sale or exchange" had consistently been construed to include the transfer of property in satisfaction of a monetary obligation. *Albernaz* v. *United States*, 450 U.S. 333, 341 (1981). In addition, the Commissioner's interpretation of the phrase "sale or exchange" comports with "[t]he normal rule of statutory construction * * * that 'identical words used in different parts of the same act are intended to have the same meaning'" (*Sorenson* v. *Secretary of the Treasury*, 475 U.S. 851, 860 (1986); see also *Ardestani* v. *INS*, 112 S. Ct. 515, 519 & n.2 (1991)), as well as this Court's admonition in *Commissioner* v. *Lester*, 366 U.S. 299, 304 (1961), that "the Code must be given 'as great an internal symmetry and consistency as its words permit.'" Accordingly, it is proper to turn first to the settled meaning of "sale or exchange" when construing Section 4975(c)(1)(A).

But even if "sale or exchange" had not had a settled meaning under the Internal Revenue Code, it would be clear that Section 4975(c)(1)(A) prohibits the transfer of property in satisfaction of a debt. Congress did not merely prohibit a "sale or exchange," it barred "any direct or indirect * * * sale or exchange" between employers and the pension plans they sponsor. At the least, the contribution of property in satisfaction of a funding obligation is a type of sale of the property. It is equally surely a form of exchange, since the property is exchanged for diminution of the employer's funding obligation.

2. Construing Section 4975(c)(1)(A) in accordance with its broad language and the settled meaning of "sale or exchange" is necessary to accomplish Congress's goal in enacting the provision, which was to bar categorically transactions that are likely to injure pension plans. S. Rep. No. 383, *supra*, at 95-96. The transfer of property to a pension plan in satisfaction of a funding obligation can jeopardize the ability of the plan to pay promised benefits, and Congress sought to eliminate that possibility by enacting Section 4975 of the Code and Section 406 of ERISA. Just as a disqualified person may directly sell property to a plan for more than its fair market value, thereby putting in jeopardy the plan's ability to pay promised benefits, an employer may overstate the value of property contributed in satisfaction of a funding obligation and similarly jeopardize the plan's ability to pay promised benefits. Preventing the possibility that such a non-arm's-length transaction might go undiscovered or uncorrected was one the principal purposes of Section 4975(c). S. Rep. No. 383, *supra*, at 32.

The facts of *Wood*—the Fourth Circuit decision that conflicts with the decision of the Fifth Circuit in this case—illustrate the potential for abuse. In that case, three promissory notes were contributed to a pension plan and valued at $114,000 "although the total fair market value of the notes at the time they were transferred to the plan was only $94,430." Pet. App. 20a. In effect, the taxpayer in *Wood* caused the plan to purchase the notes at prices substantially higher than the plan would have had to pay on the open market, if the trustee of the plan had chosen to purchase such notes. *Id.* at 25a. Short of conducting a transaction-by-transaction analysis of every contribution of property to a pension plan, which Congress sought to avoid by enacting categorical

prohibited transaction rules, there can be no assurance that insiders will deal with the pension funds in an arm's-length manner and in the best interest of the pension plan.

Nor does the potential for abuse end with the possibility of overstatements of value. Under the court of appeals' holding in this case, an employer who owns real property located in a depreciating area, or other problem or illiquid investments that it cannot readily sell, may contribute that property at its appraised fair market value to a plan, thereby using the plan as a convenient buyer. Even if the property is not overvalued, the pension plan then would bear the burden of disposing of the property.

Furthermore, it is the plan's fiduciaries who are responsible for prudent investment of the trust fund's assets. By contributing property in satisfaction of a plan's funding requirements, the employer attempts to impose its judgment as to the investment policies of the trust fund for the judgment of the persons who rightfully have that responsibility.[11]

The facts of this case illustrate the potentially harmful effects of prohibited transfers of property to a pension plan even when the property is not overvalued. The exclusive sales listing agreements that respondent had en-

[11] If contributions of property were allowed, trustees of pension plans would have to examine the prudence of accepting each contribution. But in our view, Congress did not intend to rely on such individualized applications of the prudent man investment standard (see 29 U.S.C. 1104) to sales of property by employers to the plans they sponsor—such a requirement would be costly and burdensome. Instead, it meant to prohibit such transfers altogether whenever they amount to a "sale or exchange" or the transferred property was encumbered.

tered into on two of the truck terminals called for the payment of sales commissions of at least five percent, which shows that it is neither easy nor costless to dispose of such property. See Affidavit of James Stanis, Exhs. E.3, E.4. Respondent transferred the cost of disposing of the properties to the plan when it contributed the properties to the plan. Moreover, having invested in the properties, the plan trustees could not easily dispose of them: the Chicago truck terminal was listed for sale by the Pension Trust on June 17, 1983, soon after it was received from respondent, but it was not sold for three and one-half years. *Id.*, Exhs. H, I, and J.

The court of appeals suggested that all of these problems were solved by 26 U.S.C. 4971, which imposes an excise tax on employers whose plans are underfunded. Pet. App. 8a. But Section 4975 was enacted to eliminate the need for case-by-case evaluations of transactions between pension plans and insiders, thereby preventing potentially abusive transactions from occurring, which in turn would prevent pension plans from *becoming* underfunded. S. Rep. No. 383, *supra*, at 32. That Section 4975(c)(1)(A) imposes a categorical rule is clear from the language of the statute. For example, an ordinary sale of property by an employer to a pension plan clearly is prohibited by Section 4975(c)(1)(A) even if it is undisputed that the plan paid fair market value for the property. See, *e.g.*, *Leib* v. *Commissioner*, 88 T.C. 1474, 1481 (1987) ("[t]he fact that the transaction would qualify as a prudent investment when judged under the highest fiduciary standards is of no consequence"). Section 4971, by contrast, imposes a tax on accumulated funding deficiencies that have already occurred, whether caused by plan losses, insider transactions, or otherwise. Thus, the focus of each of the two provisions is very different.

Moreover, Section 4971, by itself, does not fully address the underfunding problem. The underfunding of the plan, and thus the possible application of Section 4971, often becomes evident only when overvalued property is ultimately sold. If this takes a number of years (as it did in this case), the employer will have underfunded the pension plan for that period of time and may have escaped liability for any penalty. Even if the property is not overvalued, the plan may incur sales costs in disposing of the property and therefore ultimately receive less than the credit that the employer took for the contribution. Furthermore, if the pension plan fails while it is still holding the property, the employer will have escaped application of Section 4971, and will have saddled the Pension Benefit Guaranty Corporation (PBGC) with the hidden shortfall.[12] And since the level of benefits guaranteed by the PBGC is limited, participants and beneficiaries may suffer actual losses due to the underfunding. See 29 U.S.C. 1322, 1322a. Section 4975, and not Section 4971, prevents these abuses.

B. The Court Of Appeals Erred By Concluding That Section 4975(f)(3) Limits The Meaning Of "Sale Or Exchange" In Section 4975(c)(1)(A)

1. The court of appeals interpreted "sale or exchange" in Section 4975(c)(1)(A) contrary to its ordinary, settled meaning primarily as a result of its erroneous construction of Section 4975(f)(3). That provision states, in pertinent part, that "[a] transfer [of] real or personal property

[12] The amicus brief filed by the PBGC provides a number of examples of cases where it has assumed responsibility for underfunded plans holding overvalued property.

by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien." The court of appeals called Section 4975(f)(3) a "definition" and read it as "implying that unless [property] is encumbered by a mortgage or lien, a transfer of property is not to be treated as if it were a sale or exchange." Pet. App. 5a.[13]

In *Wood*, the Fourth Circuit expressly disagreed with the construction given to Section 4975(f)(3) by the Fifth Circuit, and instead agreed with the Commissioner that Section 4975(f)(3) "serves the special need of expanding the scope of prohibition when *encumbered* property is involved." Pet. App. 28a. Thus, the Fourth Circuit held that Section 4975(f)(3) does not restrict the meaning of "sale or exchange" in Section 4975(c)(1)(A). The Fourth Circuit gave Section 4975(f)(3) its more natural reading, and the one that is more logical in the statutory context.

Section 4975(f), which has five subsections, sets out "other definitions and special rules" for purposes of Section 4975. Three of those subsections (subsections (f)(2), (f)(4), and (f)(5)) provide definitions (for "taxable period," "amount involved," and "correction" and "correct"). Section 4975(f)(3) does not purport to define "sale or exchange." It instead contains a "special rule."[14] The statutory text at issue—providing that a transfer of encumbered property "shall be treated as" a sale or exchange—supports the Fourth Circuit's view that Congress intended Section 4975(f)(3) to expand the scope of the prohibited transaction provision. The phrase "shall be treated as" necessarily recognizes that another subsection (Section 4975(c)(1)(A)) prohibits "sales or exchanges," and specifies that transfers of encumbered property "shall be treated as" a sale or exchange even when they would not qualify as a "sale or exchange" under Section 4975(c)(1)(A). Thus, Section 4975(f)(3) amplifies and extends the reach of "sale or exchange" in Section 4975(c)(1)(A) to include contributions of encumbered property that do not satisfy funding obligations.

The legislative history confirms that Congress understood Section 4975(f)(3) to enlarge, rather than restrict, the reach of the prohibited transaction provision. The Conference Report first stated that "the direct or indirect sale, exchange, or leasing of any property between the plan and a party-in-interest * * * is a prohibited transaction." H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 307 (1974). "Also," the report continued, "following the private foundation rules of the tax law, a transfer of property by a party-in-interest to a plan is treated as a

[13] If Section 4975(f)(3) actually defined "sale or exchange" for purposes of Section 4975, and limited that definition to transfers of encumbered property, then that would mean that employers could directly sell unencumbered property to their pension plans for cash. We doubt that the court meant to suggest that extreme result. Rather, we understand the court to have held that Section 4975(f)(3) creates a negative implication limited to contributions of property, not sales for cash.

[14] The fact that Section 4975(f)(3) contains a "special rule" rather than a "definition" of "sale or exchange" is confirmed by the contrast between it and subsections (f)(2), (f)(4), and (f)(5), each of which begins "[t]he term '____' means." In addition, as we explain at page 28, *infra*, Section 4975(f)(3) was modeled on 26 U.S.C. 4941(d)(2)(A), part of the provision governing contributions to private foundations, and Section 4941(d)(2) sets out "special rules," while another subsection (Section 4941(e)) contains "definitions."

sale or exchange if the property is subject to a mortgage or a similar lien." *Id.* at 308. Thus, Congress intended Section 4975(f)(3) to provide additional protection, not to limit the protection provided by Section 4975(c)(1)(A).

2. In support of its construction of Section 4975(f)(3), the court of appeals opined that the government's construction renders the provision "superfluous." Pet. App. 5a. The court was mistaken. It focused exclusively on defined *benefit* pension plans (see note 1, *supra*), and concluded that *any* transfer of property to such a plan would qualify as a "sale or exchange" under the normal meaning of that phrase. The court reasoned that, even if the value of the contribution exceeded the employer's current funding obligation, the contribution would satisfy a future funding obligation.[15] The court did not appreciate the fact that many employers sponsor defined *contribution* pension plans, such as profit-sharing plans. Some profit-sharing plans do not mandate any contributions, but instead specify how any contributions that are made are to be distributed among plan participants. An employer is not barred by Section 4975(c)(1)(A) from contributing property to such a plan, because the contribution of property to such a plan does not satisfy any obligation to the plan. Nor would an employer be barred by

[15] As a practical matter, the treatment of payments to defined benefit pension plans in excess of those required to satisfy current funding obligations is largely a nonissue. Section 4972 imposes an excise tax on contributions to defined benefit pension plans that are not deductible, and Section 404 generally limits deductible contributions to such plans to amounts necessary to satisfy the employer's minimum funding obligation and the amortization of past unfunded liabilities to the plan. See Kirschbaum, *Investment of Pension Plan Assets: Selected Unrelated Business Taxable Income and Prohibited Transaction Issues*, 44 U.S.C. Annual Tax Inst. (Major Tax Planning) ¶ 901.6, at 9-48 (Univ. S. Cal. 1992).

Section 4975(c)(1)(A) from contributing property to a profit-sharing plan that provided that a certain percentage of profits was to be contributed each year, if the property were contributed on top of a cash contribution of the mandated share of profits. DOL Advisory Opinion 90-05A (Mar. 29, 1990). But Section 4975(f)(3) bars contributions of *encumbered* property in all these circumstances, even though such a contribution would not be a "sale or exchange" under Section 4975(c)(1)(A).

Respondent has also argued that the Commissioner's reading of Section 4975(c)(1)(A) renders Section 4975(f)(3) superfluous. Its argument is based on the fact that "*all* transfers of property from an employer to a plan, *whether voluntary or in satisfaction of a debt*, are treated as 'sales or exchanges' under the income tax laws." Br. in Opp. 8. Thus, respondent contends, if the meaning of "sale or exchange" in Section 4975(c)(1)(A) is based on the meaning of "sale or exchange" under the income tax laws, Section 4975(f)(3) serves no purpose. Respondent overlooks the language of Section 4975(c)(1)(A), which is somewhat different from the language of the income tax provisions. For example, 26 U.S.C. 1001(c), a key income tax provision, speaks of the "sale or exchange of property" without qualification. See also 26 U.S.C. 1222. Section 4975(c)(1)(A), on the other hand, prohibits a "sale or exchange * * * of any property *between a plan and a disqualified person*" (emphasis added). A contribution of property that does not satisfy a funding obligation is generally treated as a "sale or exchange" under the income tax rules (and hence the employer must recognize any gain) because it is a "sale or exchange" *between the employer and its employees*, since the contribution generally is made in consideration of the employees' labor (rather than as a gift). See, *e.g.*,

Tasty Baking Co. v. *United States*, 393 F.2d 992, 994-995 (Ct. Cl. 1968); Rev. Rul. 75-498, 1975-2 C.B. 29, 30. But such a contribution is not a sale or exchange *between the employer and the pension plan*, since it does not satisfy an obligation of the employer to the plan. Thus, the language of Section 4975(c)(1)(A) makes clear that not every transaction that is a "sale or exchange" under the income tax rules is also a "sale or exchange" under Section 4975.

3. The Commissioner's construction of Section 4975—that it bars all contributions of property except contributions of unencumbered property that do not satisfy any obligation to a plan—is logical. Transfers of encumbered property have potential to burden a plan, and contributions of any sort of property in satisfaction of a funding obligation are likely to harm a plan. But a transfer of unencumbered property that does not satisfy a debt presents little potential for causing plan losses. Respondent's construction of Section 4975, by contrast, is contrary to common sense. While its reading of Section 4975(f)(3) protects plans from the burdens of disposing of encumbered property, even if the transfer of the encumbered property would benefit the plan, respondent reads Section 4975(f)(3) to undo the protection provided by Section 4975(c)(1)(A). Thus, in respondent's view Section 4975 prophylactically protects plans from encumbered property, while at the same time permitting employers to satisfy their funding obligations by transferring unencumbered property, despite the major potential for abuse inherent in such transactions.[16]

[16] Recognizing that the prohibited transaction rules it was enacting were exceptionally broad, Congress provided an administrative exemption procedure pursuant to which the Secretary of the Treasury and the Secretary of Labor are permitted to grant conditional or unconditional exemptions from the prohibited transaction rules. 26 U.S.C. 4975(c)(2); 29 U.S.C. 1108. In order to grant an exemption, the Secretaries must conclude "that the transaction is in the interests of the plan and its participants and beneficiaries, that it does not present administrative problems, and that adequate safeguards are provided for participants and beneficiaries." H.R. Conf. Rep. No. 1280, *supra*, at 311; see also 29 U.S.C. 1108(a); 29 C.F.R. 2570.30-2570.52 (1991). Under respondent's reading of Section 4975, however, a transfer of unencumbered property in satisfaction of an obligation is not subject to administrative examination to determine whether it is in the best interests of the plan; rather, such transfers are not barred at all.

Moreover, if Congress had wanted to allow employers to satisfy their funding obligations by contributing unencumbered property to pension plans, the logical place to make that clear in the statute would have been in Section 4975(d), the statutory exemption provision, rather than by negative implication from a "special rule" in Section 4975(f). Cf. *Ingersoll-Rand Co.* v. *McClendon*, 111 S. Ct. 478, 484 (1990) ("[h]ad Congress intended to restrict ERISA's pre-emptive effect to state laws purporting to regulate plan terms and conditions, it surely would not have done so by placing the restriction in an adjunct definition section while using the broad phrase 'relate to' in the preemption section itself"). In fact, Congress established an exemption in Section 4975(d)(13) which, among other things, allows employers to contribute stock to pension plans in certain circumstances. That exemption supports our contention that Section 4975(c)(1)(A) generally prohibits contributions of unencumbered property (such as stock). It also shows that Congress placed exemptions to Section 4975(c)(1)(A) in the "exemption" provision, not in the "other definitions and special rules" provision.

4. The court of appeals also read Section 4975(f)(3) out of its historical context. Section 4975 was modeled on Section 4941, which deals with contributions to private foundations. See S. Rep. No. 383, *supra*, at 98 (in enacting Section 4975, Congress intended to "follow[ ] the private foundation rules"). Section 4941 contains provisions nearly identical to Sections 4975(c)(1)(A) and 4975(f)(3).[17] Like Section 4975(c)(1)(A), Section 4941(d)(1)(A) defines "self-dealing" to include the "sale or exchange * * * of property between a private foundation and a disqualified person." Like Section 4975(f)(3), Section 4941(d)(2)(A) provides, as a "special rule," that a transfer of property by a disqualified person to a private foundation "shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien."[18] Contributions of property to private foundations typically are *not* made in satisfaction of legal obligations but, rather, are gifts. Hence, it is clear that the central function of Section 4941(d)(2)(A), the provision that is analogous to Section 4975(f)(3), was to expand the definition of "sale or exchange" in order to establish that the voluntary transfer of encumbered property to private foundations constitutes a prohibited "sale or exchange" of the property transferred.

[17] The reasons for enacting Section 4941 were virtually identical to those later given by Congress for enacting Section 4975. Prior to 1969, self-dealing transactions between private foundations and disqualified persons were prohibited only if the transactions did not satisfy an "[a]rm's-length standard[ ]." S. Rep. No. 552, 91st Cong., 1st Sess. 28 (1969). As the Senate Finance Committee stated in enacting Section 4941, "[a]rm's-length standards have proved to require disproportionately great enforcement efforts, resulting in sporadic and uncertain effectiveness of the provisions." S. Rep. No. 552, *supra*, at 28-29.

[18] The court of appeals mistakenly stated that "Section 4941 * * * contains no definition of a sale or exchange as found in Section 4975(f)(3)." Pet. App. 8a. (We, of course, disagree that those parallel provisions constitute "definitions.")

C. The Agencies That Administer ERISA Have Reasonably Concluded That Employers May Not Fulfill Their Funding Obligations By Contributing Property To Pension Plans

An agency's construction of a statute that it is charged with administering is entitled to considerable weight. *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-843 (1984). This Court and others have recognized that this rule is particularly applicable with respect to ERISA. *Mead Corp.* v. *Tilley*, 490 U.S. 714, 726 (1989) ("[f]or a court to attempt to answer these questions without the views of the agencies responsible for enforcing ERISA, would be to 'embar[k] upon a voyage without a compass'" (citation omitted)); *Blessitt* v. *Retirement Plan for Employees of Dixie Engine Co.*, 848 F.2d 1164, 1167 (11th Cir. 1988) ("we owe great deference to the interpretations and regulations of the Pension Benefit Guaranty Corporation ('PBGC'), the Internal Revenue Service ('IRS') and the Department of Labor, which are the administrative agencies responsible for enforcing and interpreting ERISA"); *Rose* v. *Long Island R.R. Pension Plan*, 828 F.2d 910, 918 (2d Cir. 1987), cert. denied, 485 U.S. 936 (1988) ("[b]ecause the IRS is one of the agencies charged with administering ERISA, its interpretations of the statute are entitled to great deference").

When it enacted parallel prohibited transaction provisions in Title 26 and Title 29, Congress stated that, "[t]o the maximum extent possible, the prohibited transaction rules are identical in the labor and tax provisions, so

they will apply in the same manner to the same transaction." H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 295-296 (1974). To ensure consistency, the Department of Labor has primary authority to construe both sets of prohibited transaction rules. Reorg. Plan No. 4 of 1978, § 102, 92 Stat. 3790. In DOL Advisory Opinion 81-69A (July 28, 1981) (App., *infra*, 1a-3a), the Department addressed the precise issue presented in this case and ruled that a sponsoring employer's transfer of unencumbered property to a pension plan to satisfy its funding obligation was a prohibited "sale or exchange." The ruling concluded that such a transaction "constitutes a discharge by the Employer of its legal obligation to make the contribution for that year," so that "[i]n effect, the Plan is exchanging its legal rights to payment of the contribution for property other than cash." App., *infra*, 2a. The Department explained that "no inference should be drawn from the rule [barring contributions of encumbered property] that a contribution of property by an employer, in discharge of its legal obligation to contribute, would be permissible." *Id.* at 2a-3a. Accord, DOL Advisory Opinion 90-05A (Mar. 29, 1990).[19] The other agencies that administer ERISA join that conclusion, which the Commissioner urges this Court to adopt in this case.[20]

[19] In DOL Advisory Opinion 90-05A, the Department concluded that where the contribution of "property to the Plan is purely voluntary, and will not relieve the Employer of any obligation to make a cash contribution to the Plan," it "would not constitute a prohibited transaction." App., *infra*, 6a.

[20] The court of appeals in this case declined to accord any significance to the advisory opinions of the Department of Labor because such opinions are binding only on the parties. Pet. App. 7a-8a. But advisory opinions of the Department of Labor constitute official expressions of the Department's position respecting ERISA and have been so treated by the courts. See, *e.g.*, *Massachusetts* v. *Morash*, 490 U.S. 107, 118 n.14 (1989); *Fraver* v. *North Carolina Farm Bureau Mutual Insurance Co.*, 801 F.2d 675, 677-678 (4th Cir. 1986); *Shea* v. *Wells Fargo Armored Service Corp.*, 810 F.2d 372, 376 (2d Cir. 1987). Accordingly, opinions expressed in such pronouncements fall within the rule that an agency's construction of a statute that it is charged with administering is entitled to considerable weight. Indeed, consistent with the relevant authority on this issue, the Fifth Circuit recently acknowledged (after it issued its decision in this case) that "DOL opinions 'constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance,' " *MDPhysicians & Associates, Inc.* v. *State Board of Insurance Co.*, 957 F.2d 178, 186 n.9, cert. denied, 113 S. Ct. 179 (1992), quoting *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944), and that it "consider[s] the opinions of the Department of Labor of persuasive value" (957 F.2d at 186 n.9).

It is also instructive that the Internal Revenue Service has accorded the same meaning to the phrase "sale or exchange" in interpreting Section 4941 of the Internal Revenue Code, the provision upon which Section 4975 was modeled. S. Rep. No. 383, *supra*, at 32; H.R. Conf. Rep. No. 1280, *supra*, at 306. In Rev. Rul. 81-40, 1981-1 C.B. 508, a disqualified person attempted to correct an act of self-dealing (the borrowing of money from a private foundation) by transferring real estate to the private foundation in cancellation of the indebtedness. The IRS ruled that the transfer of the property in satisfaction of the indebtedness would constitute a second act of self-dealing, because the transfer of the property in satisfaction of the indebtedness would be a sale of property within the meaning of Section 4941. Similarly, in Rev. Rul. 77-379, 1977-2 C.B. 387, the Service ruled that the transfer of stock by a private foundation in repayment of a loan by a disqualified person was "tantamount

to a sale or exchange of property between a private foundation and a disqualified person within the meaning of section 4941(d)(1)(A)."[21]

At the least, the agencies that administer ERISA have construed Section 4975 reasonably. Accordingly, the Fourth Circuit in *Wood* properly gave considerable weight to the interpretation of those agencies. Pet. App. 28a-29a. This Court should do the same, particularly since the administrative construction of the phrase "any direct or indirect * * * sale or exchange" in Section 4975(c)(1)(A) is straightforward and is the only one that comports with the statutory context and with the expressed congressional intent.

[21] See also Treas. Reg. § 1.415-6(b)(4), which, in the context of a defined contribution plan, warns that a contribution of property may "constitute a prohibited transaction within the meaning of section 4975(c)(1)."

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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NOVEMBER 1992

APPENDIX A

DEPARTMENT OF LABOR
PENSION & WELFARE BENEFIT PROGRAMS
OPINION 81-69A
JULY 28, 1981

OPINION:

This is in reply to your letter of June 19, 1980, in which you requested a ruling that the contribution by an employer of an option to a defined benefit plan does not violate section 4975 of the Internal Revenue Code. For purposes of our reply, all references to the Code contained in your letter will be treated as references to corresponding provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

You represent that Conahan & Conahan, Attorneys at Law, A Law Corporation (the Employer) established the Conahan & Conahan, Attorneys at Law, A Law Corporation Defined Benefit Pension Plan (the Plan) and that the Plan received a favorable determination letter from the Internal Revenue Service in July 1970. The Plan is a defined benefit plan. The Employer holds an option to purchase a residential condominium unit which it acquired from James P. Conahan and Kathleen K.O. Conahan, the apparent owners of the unit. As part of its corporate contribution to the Plan, the Employer wishes to make a contribution of the option to the Plan.

Section 406(a)(1)(A) of ERISA provides that a fiduciary with respect to a plan shall not cause a plan to engage in a transaction, if he knows or should know that such a transaction constitutes a direct or indirect sale or exchange between a plan and a party in

interest. Section 3(14)(C) provides that a party in interest means an employer any of whose employees are covered by the plan. An employer assumes with respect to a defined benefit plan an obligation to make contributions to fund promised benefits. The contribution of the option by the Employer to the Plan constitutes a discharge by the Employer of its legal obligation to make the contribution for that year. In effect, the Plan is exchanging its legal right to payment of the contribution for property other than cash. Accordingly, the contribution of the option by the Employer is a prohibited sale or exchange of property between a plan and a party in interest under section 406(a)(1)(A) of ERISA.

You argue that section 406(c) of ERISA compels the conclusion that only encumbered contributions of real or personal property by an employer are prohibited by section 406(a)(1)(A). Section 406(c) provides that a *transfer* of real or personal property by a party in interest to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or lien which the plan assumes or it is subject to a mortgage or similar lien which a party in interest placed on the property within the 10 year period ending on the date of the transfer (emphasis added). Following the private foundation rules of the tax law applicable to gifts of property to private foundations, this rule prevents a party in interest from circumventing the section 406(a)(1)(A) prohibition on sales or exchanges by getting a loan on the property and donating it to a plan which must either pay off the loan or give up the property. See Conference Report 93-1280, 93rd Congress, 2d Sess., at 308. The applicability of the rule is limited to voluntary transfers of property which Congress considered to be sales or exchanges and no inference should be drawn from the rule that a

contribution of property by an employer, in discharge of its legal obligation to contribute, would be permissible.

In addition, you should be aware that, based on your letter, it appears that the exercise of the option by the Plan might also constitute a violation of section 406(a)(1)(A) of ERISA.

This letter constitutes an advisory opinion under ERISA Procedure 76-1 (issued August 27, 1976). Accordingly, it is issued subject to the provisions of the procedure, including section 10 thereof relating to the effect of advisory opinions.

Alan D. Lebowitz
Assistant Administrator for Fiduciary Standards
Pension and Welfare Benefit Programs

APPENDIX B

DEPARTMENT OF LABOR
PENSION & WELFARE BENEFITS ADMINISTRATION
OPINION 90-05A
MARCH 29, 1990

OPINION:

This is in response to your letter of January 5, 1989, in which you requested an advisory opinion regarding the application of the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 (ERISA) to a contribution by an employer of real property to an employee stock ownership plan.

You represent that the Edelbrock Corporation Employee Stock Ownership Plan, Stock Bonus Portion (the Plan) is a stock bonus plan qualified under section 401(a) of the Internal Revenue Code of 1986 (the Code). The Plan, in conjunction with a money purchase pension plan, is intended to constitute an employee stock ownership plan under section 407(d)(6) of ERISA. As an employee stock ownership plan, the Plan is designed to invest primarily in stock of the Edelbrock Corporation (the Employer).[1]

You further represent that the Board of Directors has resolved to contribute two light industrial commercial buildings owned by the Employer to the Plan. The properties (known as Building #4 and Building #8) are located in the Edelbrock Chandler Business Park, Chandler, Arizona. The buildings are currently owned outright by the Employer, i.e., there are no mortgages or other liens against them. The properties are tenant occupied subject to transferable leases expiring in 1991, and they are valued based on independent MIA appraisal taking into account the value of the existing leases. The contribution will not create any ongoing relationship between the Plan and a party in interest. Subsequent to the proposed contribution, real estate will comprise 10.4 percent of plan assets, cash and cash equivalents 5.2 percent, and qualifying employer securities will make up the remaining 84.4 percent of plan assets.

[1] In this regard, you indicate that the Plan has not borrowed funds in order to finance the purchase of employer securities under section 408(b)(3) of ERISA.

According to your representations, the Plan is funded at the discretion of the Board of Directors. The proposed contribution is purely voluntary, and would not relieve the Employer of an obligation to make a cash contribution to the Plan. In this regard, you have specifically represented that the proposed contribution of real property is not a substitute for a previously resolved cash contribution, and that no part of the contribution will be used to satisfy any required contribution to the related money purchase plan.

In effect, you request the following opinions:

1) that the contribution of real property to the Plan will not violate section 406 of ERISA, and

2) that the investment of 15.6 percent of the Plan's assets in investments other than qualifying employer securities will satisfy the requirement that an employee stock ownership plan be "designed to invest primarily in qualifying employer securities" for purposes of section 407(d)(6) of ERISA.

Section 406(a)(1)(A) of ERISA provides that a fiduciary with respect to a plan shall not cause a plan to engage in a transaction if he knows or should know that such transaction constitutes a direct or indirect sale or exchange, or leasing, of any property between a plan and a party in interest. Section 3(14) of ERISA

defines a "party in interest" to include a fiduciary, a person providing services to a plan, and an employer any of whose employees are covered by such plan.

With respect to the first issue, the Department of Labor (the Department) addressed the issue of employer contributions in kind in Advisory Opinion 81-69A (July 28, 1981). In that Opinion, the Department concluded that a contribution of unencumbered property by an employer to a defined benefit plan would be a prohibited transaction under section 406(a)(1)(A) of ERISA because the contribution of such property discharged the employer of its legal obligation to make cash contributions to the plan. In effect, the plan would be exchanging its legal right to the payment of the contribution for property other than cash.

In the Department's view, contributions in kind that relieve an employer of an obligation to make cash contributions to any plan subject to Title I of ERISA, including an employee stock ownership plan, are prohibited exchanges under section 406(a)(1)(A) of ERISA. If, however, an employer's contribution in kind is purely voluntary, it is the Department's further view that such contributions in kind would not be prohibited under section 406(a)(1)(A) of ERISA.

You represent that the contribution of the real property to the Plan is purely voluntary, and will not relieve the Employer of any obligation to make a cash contribution to the Plan. Based upon the facts and representations contained in your submission, it is the view of the Department that the contribution of real property to the Plan would not constitute a prohibited transaction under section 406(a)(1)(A) of ERISA.

With respect to the second issue, the term "employee stock ownership plan" is defined under section 407(d)(6) of ERISA to mean an individual account plan which is (i) a stock bonus plan which is qualified, or a stock bonus plan and a money purchase plan both of which are qualified, under section 401 of the Code, and (ii) is designed to invest primarily in qualifying employer securities, and (iii) meets such other requirements as the Secretary of the Treasury may prescribe by regulation.

29 CFR § 2550.407d-6(a)(2) of the Department's regulations provides that to be an ESOP, a plan must be formally designated as such in the plan documents. 29 CFR § 2550.407d-6(b) further provides that a plan constitutes an ESOP only if a plan specifically states that it is designed to invest primarily in qualifying employer securities. Although the regulation does not define the term "primarily," the regulation does state that a stock bonus plan or a money purchase pension plan constituting an ESOP may invest part of its assets in other than qualifying employer securities. In Advisory Opinion 83-6A (January 24, 1983), the Department stated that neither ERISA nor the applicable regulations promulgated thereunder contain maximum or minimum percentages of plan assets which must be invested in qualifying employer securities over the life of the ESOP in order to satisfy the "primarily" requirement of section 407(d)(6) of ERISA. The Department concluded that a plan provision requiring the plan to invest more than 50 percent of its assets in qualifying employer securities would not, in itself, contravene the requirement of ERISA section 407(d)(6) that an ESOP invest primarily in qualifying employer securities. [2]

[2] In this regard, we note that Advisory Opinion 83-6A emphasized the Department's belief that, in order to satisfy the ESOP requirements imposed by ERISA and applicable regulations, a plan must satisfy the "primarily" requirement of section 407(d)(6) over the life of the plan.

Accordingly, it is the responsibility of the appropriate plan fiduciaries to determine, based on all of the relevant facts and circumstances, the composition of the plan's portfolio, including the percentage of plan assets to be invested in qualifying employer securities in any particular instance. In this regard, we note that compliance with a plan provision would not insulate the fiduciaries from liability under section 404 of ERISA should prudence or exclusive benefit requirements dictate an alternative investment course of action.

The Department notes that ERISA's general standards of fiduciary conduct would apply to your proposed contribution in kind. Section 404(a)(1)(B) of ERISA requires that a fiduciary discharge his duties to a plan solely in the interests of the participants and beneficiaries, and with care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man would use in the conduct of an enterprise of a like character and with like aims. Accordingly, the fiduciaries of the Plan must act "prudently" and "solely in the interest" of the Plan's participants and beneficiaries when deciding whether to accept the contributions in kind. If accepting the contribution of the property by the Plan is neither "prudent" nor "solely in the interest" of the Plan's participants and beneficiaries, the fiduciaries of the Plan would be liable for any loss resulting from such breach of fiduciary responsibility, even though the contribution of the real property may not constitute a prohibited transaction under section 406 of ERISA.

This letter constitutes an advisory opinion under ERISA Procedure 76-1. Accordingly it is issued subject to the provisions of the procedure, including section 10 thereof, relating to the effect of advisory opinions.

Robert J. Doyle
Director of Regulations and Interpretations

(7)

No. 91-1677

In The

Supreme Court of the United States

October Term, 1992

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

BRIEF OF THE RESPONDENT

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58 pp

QUESTION PRESENTED

Whether Congress intended, when it enacted ERISA, to impose penalty taxes on any employer who contributes property other than cash to a defined benefit pension plan.

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No. 91-1677

In The

Supreme Court of the United States

October Term, 1992

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

BRIEF OF THE RESPONDENT

STATEMENT

Respondent[1] generally agrees with Petitioner's Statement of the Case. Respondent adds, however, that the properties contributed by Respondent to the Keystone Consolidated Master Pension Trust (the "Trust") were later sold by the Trust to unrelated third parties for net amounts (i.e., after selling expenses) greater in the aggregate than the fair market value of the properties on the dates of contribution. Petitioner has never suggested that Respondent overvalued the properties that it contributed,

[1] Respondent has no parent corporation and no subsidiaries other than wholly owned subsidiaries.

nor has Petitioner previously argued that the facts of this case represent in any way an abusive transaction.

SUMMARY OF ARGUMENT

Section 4975(c)(1)(A) of the Internal Revenue Code of 1986 (the "Code") describes the "sale or exchange, or leasing, of any property" between an employer and a pension plan as a "prohibited transaction." In direct contravention of Petitioner's own administrative interpretation and the ordinary meaning of the phrase "sale or exchange," Petitioner now argues that this statutory language, enacted as part of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. 1001 *et. seq.*, creates "a categorical rule" barring employers from contributing property to pension plans. Pet. Br. at 12. Relying on her "categorical" rule, Petitioner now seeks to impose approximately $13 million in penalties against Respondent. The Tax Court and the United States Court of Appeals for the Fifth Circuit both rejected the Petitioner's position and held that a "contribution" of property by an employer to a defined benefit pension plan is not a "sale or exchange" within the meaning of Code § 4975(c)(1)(A).

The two-tier excise taxes imposed by Code § 4975 are penalty taxes. Under this Court's precedents, Code § 4975 must be strictly construed and its penalties can apply only when the words of the statute plainly impose them. The words do not impose them here. If Congress had intended to prohibit contributions of property to pension plans, it would have done so expressly. Congress did not do so. Indeed, in language that is dispositive of this case, Code § 4975(f)(3) states that a transfer of property by an employer to a plan "shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes. . . . " Congress enacted this provision so that an employer could not borrow money by using property as collateral and then force the plan to repay the indebtedness by contributing the property subject to the mortgage. Under Petitioner's view that there is a "categorical rule barring employers from contributing property to pension plans," Code § 4975(f)(3) makes no sense.

Petitioner argues that Code § 4975(f)(3) was designed to expand Code § 4975(c)(1)(A) so that purely "voluntary" contributions of mortgaged property to a pension plan would be treated as a "sale or exchange." The words "voluntary" or "involuntary," however, appear nowhere in the statute, and there is no indication in the statute or legislative history that Congress was aware of, or gave any thought to, such a distinction. Moreover, the income tax case law that Petitioner relies on as her sole support for her definition of a "sale or exchange" has never distinguished between a "voluntary" and an "involuntary" contribution. *All* contributions to pension plans have been treated as "sales or exchanges" for federal income tax purposes since long before Congress enacted ERISA.

Petitioner now concedes that an employer's "voluntary" contribution of property to a pension plan is a "sale or exchange" for income tax purposes. She argues nevertheless that it is a "sale or exchange" between the employer and the employees and thus is not a prohibited

transaction. Under fifty years of income tax law, however, any transfer of property subject to a mortgage is a "sale or exchange" *between the transferor and the transferee* because the transferee must either pay the indebtedness or relinquish the property. Petitioner thus asks this Court to apply the income tax definition of a "sale or exchange" when interpreting Code § 4975(c)(1)(A), but to ignore that definition when interpreting Code § 4975(f)(3). Petitioner is forced to this inconsistent position in an attempt to reconcile her argument with the plain meaning of Code § 4975(f)(3).

Petitioner's argument that a contribution of property should be a prohibited transaction is patently inconsistent with the statutory structure established in ERISA to govern contributions to defined benefit pension plans. Code § 404(a) provides a tax deduction for both cash and noncash contributions to defined benefit plans. It is inconceivable that Congress would grant a deduction for a "prohibited transaction." Code § 412(b) provides that defined benefit pension plans must establish and maintain a "funding standard account," which account is increased by the "amount considered contributed" by the employer. Code § 412 is the statutory source for an employer's funding obligation that, according to Petitioner, converts a transfer of property into a prohibited "sale or exchange." There is nothing, however, in Code § 412 that suggests that an employer must contribute cash in order to fund its pension plan or to increase its funding standard account.

To enforce Code § 412, Code § 4971 imposes a two-tier excise tax on any employer who maintains a pension plan with an "accumulated funding deficiency." Code

§ 4971 is the penalty imposed on an employer that fails to make contributions to a plan. If an employer contributes noncash property to a plan and overvalues that property, Petitioner is permitted under Code § 4971 to assert excise taxes against the employer for failing to meet its funding requirements. Code § 4971 does *not* require employers to make cash contributions.

Petitioner and the amicus argue that this Court should reject the opinions of the Tax Court and the Fifth Circuit and instead defer to the administrative interpretations of the Department of Labor (the "DOL") (as expressed in an unpublished advisory opinion) and the Internal Revenue Service (the "IRS") (as expressed in revenue rulings interpreting a different statute than the one at issue here). Petitioner's argument for deference is more than merely wrong – it is an outrageous abuse of process. Until 1989, six years after Respondent made the contributions at issue in this case, Petitioner's own administrative position, as articulated in the Internal Revenue Manual, was that it was *not* a prohibited "sale or exchange" for an employer to contribute noncash property to a defined benefit plan unless the plan documents themselves imposed an obligation on the employer to contribute cash to the plan. In 1989 Petitioner amended her administrative position, stating only that a contribution of property to a defined benefit plan "*may*" be a prohibited "sale or exchange" depending on the application of Code § 4975(f)(3), i.e., if the property is subject to a mortgage.

The Internal Revenue Manual is the only place (other than in this case) where the IRS has expressed an administrative interpretation of Code § 4975. Respondent

respectfully submits that it is an outrage for Petitioner now to assert $13 million in penalties against one particular taxpayer when Petitioner for years advised the revenue agents who audit employers that a contribution of unencumbered property was *not* a prohibited "sale or exchange."

ARGUMENT

I. THE STATUTORY LANGUAGE OF CODE § 4975 AND STATUTORY STRUCTURE GOVERNING PENSION PLAN FUNDING PERMIT AN EMPLOYER TO CONTRIBUTE NONCASH PROPERTY TO A PENSION PLAN

A. The Statutory Scheme That Governs Plan Funding And Imposes Funding Obligations Demonstrates That Congress Understood And Expected That Employers Would Fund Defined Benefit Plans With Noncash Property

Petitioner argues that a contribution of property from an employer to a pension plan in satisfaction of a statutory funding requirement is a prohibited "sale or exchange." Her sole authority for this position is that a transfer of property in satisfaction of an indebtedness is treated as a "sale or exchange" under the income tax laws for purposes of recognizing gain or loss. In making her argument, however, Petitioner completely ignores the statutory structure of ERISA. It is essential to understand this structure to understand why a "contribution" of property within the meaning of ERISA is not a prohibited "sale or exchange."

Employers establish defined benefit pension plans to pay retirement benefits to employees based on employment service. An employer that maintains a defined benefit plan promises a fixed benefit to its employees upon retirement. Prior to the enactment of ERISA, employees on occasion suffered substantial hardship when an employer failed to meet its promises to provide a fixed retirement benefit. Congress enacted ERISA to ensure that workers received those benefits. One of the principal purposes of ERISA was to establish a tax structure under which employers would have to make annual contributions to pension trusts sufficient to ensure that funds would later be available to pay benefits. The various elements of that tax structure demonstrate that Congress intended to permit noncash contributions of property.

1. Code § 412, the statute that imposes funding obligations, does not require cash contributions

Under a defined benefit plan, an employer promises to pay retirement benefits to employees based on each employee's service. In contrast to a defined contribution plan, the employer promises "benefits" rather than "contributions." In order to ensure that funds are available to pay promised benefits, however, Congress enacted Code § 412. Under Code § 412(b), employers must establish and maintain a "funding standard account" so that pension trusts will have adequate resources to pay benefits. Code § 412(a) provides that an employer shall have satisfied its "minimum funding standard" if the funding standard account does not have "an accumulated funding deficiency." Code § 412(b)(3)(A) then states that the funding

standard account shall be credited with "the amount *considered* contributed by the employer to or under the plan for the plan year" (emphasis added).

Code § 412 is a long and comprehensive statute that covers every aspect of an employer's obligation to fund a defined benefit pension plan. The statute even includes provisions authorizing the Treasury Department to waive an employer's funding obligation in the event of financial hardship. Code § 412(d). If Congress had intended to prohibit employers from meeting their minimum funding standard with noncash contributions, Code § 412 would be the only sensible place to impose that requirement. Nothing in Code § 412, however, even hints that an employer must fund its plan with cash only.

Because Code § 412 does not impose an obligation to contribute cash, the fundamental premise of Petitioner's case is in error. Petitioner states repeatedly that the transfer of property in satisfaction of a "monetary" or "dollar" obligation is effectively a sale of the property for cash. Pet. Br. at 8, 14. Since Code § 412 does not require cash contributions, however, an employer does not have a "monetary" obligation. Petitioner's argument is therefore circular. She believes that a cash contribution is required because a noncash contribution is a "sale or exchange." She believes that a noncash contribution is a "sale or exchange" because the contribution satisfies a cash obligation. Since no requirement to satisfy a funding obligation with cash exists, however, her argument is specious.

2. Code § 4971 provides the penalty for noncompliance with Code § 412. Nothing therein requires cash contributions

Code § 4971 is the enforcement mechanism for Code § 412. Code § 4971(a) imposes a 10% first-tier excise tax on any employer that maintains a plan with an accumulated funding deficiency (5% tax in the case of a multiemployer plan). If the accumulated funding deficiency is not later corrected, Code § 4971(b) imposes a 100% second-tier excise tax on the amount of the deficiency. The excise taxes imposed by Code § 4971 thus mirror the two-tier excise taxes under Code § 4975 that Petitioner has asserted in this case. Under Code § 4971, if an employer contributes property to a plan and the employer claims a credit for the contribution in excess of that property's fair market value, Petitioner can impose an excise tax for failing to meet minimum funding standards. Nothing in Code § 4971 prohibits an employer from contributing noncash property.

3. Code § 404 permits a deduction for noncash contributions

Code § 404(a) provides the statutory rules for when an employer may claim a tax deduction for its plan contributions. In a precursor to her litigating position here, Petitioner argued, before Congress enacted ERISA, that no deduction should be allowed under Code § 404(a) for contributions to a plan unless such contributions were in cash. The courts rejected Petitioner's argument since no such requirement appears anywhere in the statutory

language.[2] Petitioner later acquiesced in this result. *See, e.g., Colorado Nat'l Bank v. Commissioner,* 30 T.C. 933 (1958), *acq.,* 1959-1 Cum. Bull. 3; Rev. Rul. 73-345, 1973-2 Cum. Bull. 11; Rev. Rul. 75-498, 1975-2 Cum. Bull. 29.[3] Nothing in ERISA changed the pre-ERISA rule that noncash contributions are deductible. It is inconceivable that Congress would grant a tax deduction for a noncash contribution if Congress intended to classify such a contribution as a "prohibited transaction."

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[2] Code § 404 is in fact a "limiting" provision. Contributions are deductible under Code § 404 only to the extent that they would be otherwise deductible under the Code. Under Code § 83, however, transfers of property by an employer are not deductible unless and until the employees take such property into income. Congress, however, recognized that employers routinely contribute noncash property to pension plans. Therefore, Code § 83(e)(2) explicitly states that Code § 83 does not apply to "a transfer to or from a trust described in section 401(a) or a transfer under an annuity plan which meets the requirements of section 404(a)(2)." The Code therefore "explicitly contemplates" that employers would make noncash contributions to pension trusts. Edward A. Zelinsky, *Pensions and Property Contributions: Wood, Keystone, and the Supreme Court,* 56 Tax Notes 651, 655 (1992).

[3] The only form of property that does not constitute a deductible "payment" under Code § 404 is an employer's own promissory note. In *Don E. Williams Co. v. Commissioner,* 429 U.S. 569 (1977), this Court held that an employer could not claim a deduction for contributing its own promissory note to a plan because Code § 404 permits a deduction only when a contribution is actually "paid." The dissent in *Williams* noted that the Commissioner "concedes that the petitioner could have obtained its deductions had it tendered to the trust identical notes of a different company, for such a transaction would have been treated as a deductible transfer of property." *Williams,* 429 U.S. at 587 (Stewart, J. dissenting).

B. Code § 4975 Does Not List A Contribution Of Unencumbered Property As A Prohibited "Sale Or Exchange"

Code § 4975(c) contains a "specific" list of transactions that Congress prohibited per se. H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 321 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5101. The statutory language makes it clear that the purpose of Code § 4975 was to protect the assets of a plan once those assets have been contributed. The statute reads:

> (1) GENERAL RULE – For purposes of this section, the term "prohibited transaction" means any direct or indirect –
>
> (A) sale or exchange, or leasing, of any property between a plan and a disqualified person;
>
> (B) lending of money or other extension of credit between a plan and a disqualified person;
>
> (C) furnishing of goods, services, or facilities between a plan and a disqualified person;
>
> (D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;
>
> (E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or
>
> (F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from

> any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

Code § 4975(c)(1)(A) thus prohibits an employer from engaging in a "sale or exchange, or leasing, of any property" with a plan, regardless of whether the employer is the buyer or seller. Code § 4975(c)(1)(D) then prohibits a plan from transferring its "income or assets" to an employer. A transfer of property from an employer to a plan is *not* listed as a prohibited transaction.

If Congress had intended to prohibit contributions of property from an employer to a defined benefit plan, Congress could have, and would have, done so without confusion. Code § 408(a)(1), dealing with contributions to individual retirement accounts ("IRAs"), states that "no contribution will be accepted unless it is in cash." The prohibited transaction rules of Code § 4975 expressly apply to IRAs. Code § 4975(e).

Congress enacted the provision requiring cash contributions to IRAs as part of ERISA in the same bill as Code § 412 and Code § 4975. The legislative history of ERISA, while saying nothing to suggest that employers were required to make cash contributions to pension plans, states that "[C]ontributions [to IRAs] must be made in cash (currency, checks, etc.), and contributions in property are not to be deductible." H.R. Rep. No. 779, 93rd Cong., 2d Sess. 127 (1974), *reprinted in* 1974-3 Cum. Bull. 244, 370. The Congress that enacted the funding rules and the prohibited transaction rules thus knew how to require cash contributions. If Congress had intended to apply the same cash restriction to defined benefit plans, it would have stated that restriction in plain language, as it did with IRAs.

C. Code § 4975(f)(3) Demonstrates That Congress Did Not Intend To Prohibit Noncash Contributions

In language that is dispositive of this case, Code § 4975(f)(3) states:

> A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

The property that Respondent transferred to the Trust that is the subject of this case was not "subject to a mortgage or similar lien." Thus, as the Tax Court and the Fifth Circuit correctly held, the transfer of property by Respondent to the Trust was not a "sale or exchange" within the intendment of Code § 4975.

The legislative history of ERISA explains the purpose behind Code § 4975(f)(3). Both the Senate and Conference Reports state that Congress enacted Code § 4975(f)(3) to prevent an employer from mortgaging property before contributing it to a plan. Such a transaction would enable the employer to remove cash equity from the property and then force the plan later to use its cash assets to repay the mortgage. The applicable Senate Report (and a nearly identical provision in the Conference Report) states as follows:

> [A] transfer of property by a party in interest to a trust is treated as a sale or exchange if the property is subject to a mortgage or similar lien

> which the party in interest placed on the property within 10 years of the transfer to the trust, or if the trust assumes a mortgage or similar lien placed on the property prior to transfer. *This rule prevents circumvention of the prohibition on sale by mortgaging the property before a transfer to the trust.*

S. Rep. No. 383, 93rd Cong., 1st Sess. 98 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4890, 4981 (emphasis added); *see also* H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 308 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5088. This legislative history is irreconcilable with Petitioner's definition of a "sale or exchange" because it obviously contemplates that employers would make noncash contributions.

Code § 4975(f)(3) dovetails with Code § 4975(c)(1)(A). Under the ordinary, everyday definition of a "sale or exchange," Code § 4975(c)(1)(A) prevents an employer from selling property to a pension plan in exchange for plan assets. If an employer uses property as security for a loan, receives the loan proceeds, and then contributes the property subject to the mortgage to the plan, the plan will be required to use its own assets to repay the mortgage or lose the property. Since the plan will have to repay the loan made to the employer, contributions of mortgaged property represent an opportunity for an employer to extract assets from a pension plan. Congress thus classified contributions of mortgaged property as a prohibited "sale or exchange."

Code § 4975(f)(3) would be superfluous if Congress intended to incorporate the income tax definition of a "sale or exchange" into Code § 4975. Under the income tax rules, *any* transfer or contribution of property from an

employer to a pension plan is a "sale or exchange," even if the contribution is not in satisfaction of an "indebtedness." *See, e.g., Tasty Baking Co. v. United States*, 393 F.2d 992, 995 (Ct. Cl. 1968); *A.P. Smith Mfg. Co. v. United States*, 364 F.2d 831, 838 (Ct. Cl. 1966), *cert. denied*, 385 U.S. 1003; *United States v. General Shoe Corp.*, 282 F.2d 9, 12 (6th Cir. 1960), *cert. denied*, 365 U.S. 843 (1961); *International Freighting Corp. v. Commissioner*, 135 F.2d 310 (2d Cir. 1943). Moreover, any transfer of property subject to a mortgage that the transferee assumes, or any transfer of property subject to a nonrecourse indebtedness, is a "sale or exchange" *between the transferor and the transferee* because the transferee will have to pay off the indebtedness with its own assets or relinquish the property. The amount of the mortgage is included in the transferor's amount realized from the sale (plus any other consideration paid), and the transferee takes the property with a tax basis equal to the amount of the mortgage. *See Commissioner v. Tufts*, 461 U.S. 300, 307-10 (1983); *Crane v. Commissioner*, 331 U.S. 1, 13-14 (1947); Rev. Rul. 81-163, 1981-1 Cum. Bull. 433; Rev. Rul. 70-626, 1970-2 Cum. Bull. 158.

Both the Tax Court and the Fifth Circuit realized that Code § 4975(f)(3) would be meaningless if Congress intended to prohibit noncash contributions to a defined benefit pension plan under Code § 4975(c)(1)(A). Petitioner, however, argues that these courts erred because Code § 4975(f)(3) was intended to "expand," rather than "limit," the definition of a "sale or exchange" under Code § 4975. Since the Fifth Circuit and the Tax Court viewed Code § 4975(f)(3) as a limiting provision, Petitioner argues that both courts misinterpreted the statute.

Petitioner's argument is a smokescreen. When Congress enacted Code § 4975(c)(1)(A), it did not intend to treat a "contribution" of noncash property as a prohibited transaction. Respondent thus agrees that Congress enacted Code § 4975(f)(3) to *expand* the definition of a "sale or exchange" to include a contribution of encumbered property. But by "expanding" Code § 4975(c)(1)(A) in this way, the statutory language demonstrates that a contribution of unencumbered property is *not* a prohibited "sale or exchange" under Code § 4975(c)(1)(A). Whether one describes Code § 4975(f)(3) as an "expansion" or as a "limitation" thus is an exercise in semantics that offers no help in discerning Congress's intent.

1. Petitioner's interpretation of Code § 4975(c)(1)(A) renders Code § 4975(f)(3) both superfluous and ineffective

Petitioner's attempt to explain why her interpretation of Code § 4975(c)(1)(A) does not render Code § 4975(f)(3) meaningless is contrived and convoluted. Petitioner argues that Congress enacted Code § 4975(f)(3) to cover so-called "voluntary" transfers of property to a plan, i.e., transfers not in satisfaction of a current statutory funding obligation. Such voluntary transfers arise either because (i) the employer contributes more than the minimum amount necessary to meet that year's funding obligation (in the case of a defined benefit plan) or (ii) the employer has no fixed liability to contribute a particular amount of property (in the case of certain types of defined contribution plans).

Petitioner in her opening brief recognizes that even a "voluntary" transfer is a "sale or exchange" under the Internal Revenue Code. She therefore argues that a "voluntary" transfer should be viewed as a "sale or exchange" between the employers and employees and that Congress enacted Code § 4975(f)(3) to convert a "sale or exchange" between an employer and an employee into a "sale or exchange" between an employer and a plan.[4]

As enacted, the language of Code § 4975(f)(3) clearly indicates that Congress did not intend to change the pre-ERISA rule that an employer could contribute any type of property to a pension plan. To conclude, as Petitioner has, that Code § 4975(f)(3) was necessary because, in Petitioner's view, a "voluntary" contribution to a plan is a "sale or exchange" between the employer and the employees, with not a hint of supporting language in either the statute or the legislative history, is to conclude that Congress purposefully included hidden meaning in

[4] Petitioner's argument that a "voluntary" contribution of *unencumbered* property should be viewed as a "sale or exchange" between the employers and the employees is unsupported by the case law. The pre-ERISA cases holding that a contribution of unencumbered property to a pension plan was a "sale or exchange" involved "voluntary" contributions. *Tasty Baking Co.*, 393 F.2d 992; *A.P. Smith Mfg. Co.*, 364 F.2d 831; *General Shoe Corp.*, 282 F.2d 9; *International Freighting Corp.*, 135 F.2d 310. In none of these cases did the courts state who the "sale or exchange" was "between." The only relevant issue was whether there had been a "sale or exchange" at all. Since both "voluntary" and "involuntary" contributions are made *to the plan* in consideration for services to employees, there is no authority for the Petitioner's alleged distinction between "voluntary" and "involuntary" contributions.

the statute and intended to mislead employers who maintain defined benefit plans. Congress would not have enacted a statute that contains such an obviously erroneous implication.

Nothing in Code § 4975(f)(3) or the legislative history suggests that Congress intended Code § 4975(f)(3) to apply only to limited types of transfers, and nothing in Code § 4975 or the legislative history even hints at different rules for so-called "voluntary" transfers and "involuntary" transfers. Moreover, Code § 4975(f)(3) merely states that a transfer of mortgaged property "shall be treated as a sale or exchange." Thus, if Congress enacted Code § 4975(f)(3) to convert a "sale or exchange" between an employer and employees into a "sale or exchange" between an employer and a plan, Congress failed miserably. Code § 4975(f)(3) would have to state that a transfer of mortgaged property "shall be treated as a sale or exchange between a plan and a disqualified person" in order for the provision to accomplish what Petitioner states it was intended to accomplish.

More important, Petitioner's proposed distinction between "voluntary" and "involuntary" transfers of property destroys the cornerstone of her position, namely her argument that the words "sale or exchange" should be given the same definition throughout the Internal Revenue Code. As stated earlier, under the income tax law a transfer of property subject to a mortgage is a "sale or exchange" between the transferor and the transferee. *See Tufts*, 461 U.S. at 307-10; *Crane*, 331 U.S. at 13. Because the recipient of the property must pay the indebtedness or lose the property, the transferee provides consideration to the transferor for the property. The transferor treats the mortgage as part of its amount realized and the transferee treats the mortgage as part of the property's purchase price.

Petitioner's explanation of Code § 4975(f)(3) is therefore wrong. Based on the income tax law, she asserts that Congress intended for a contribution of property in satisfaction of a funding requirement to be a prohibited transaction under Code § 4975(c)(1)(A). In order to render Code § 4975(f)(3) not superfluous, however, she wants this Court to disregard that same case law and hold that a contribution of property "subject to a mortgage or similar lien that the Plan assumes" would not be a "sale or exchange" between an employer and a plan except for Code § 4975(f)(3). Petitioner cannot have it both ways. The rationale for treating a transfer of property in satisfaction of an indebtedness as a "sale or exchange" between the transferor and the transferee is the exact same rationale for treating a transfer of property subject to a mortgage as a "sale or exchange" between the transferor and the transferee. As this Court has noted, the rationale in both contexts is that the transferor has received an "immediate economic benefit" because the transferor is relieved of an indebtedness. *See Diedrich v. Commissioner*, 457 U.S. 191, 196-97 (1982). Code § 4975(f)(3) therefore is unequivocally superfluous under the Petitioner's interpretation of Code § 4975(c)(1)(A).

2. Petitioner's voluntary/involuntary distinction highlights the absurdity of her statutory interpretation

Under Petitioner's interpretation of Code § 4975(c)(1)(A), a contribution to a plan is a prohibited

"sale or exchange" when the contribution satisfies a statutory minimum funding standard *for that year*[5] under Code § 412. When an employer makes a contribution to a defined benefit plan that is not necessary to satisfy a minimum funding obligation, however, the employer increases the assets of the pension trust, receives a credit in its Code § 412 funding standard account, and may thereby reduce its funding obligation in future years.

For example, suppose Company A has a minimum funding requirement of $1,000 in 1993 and expects to have a minimum funding requirement of approximately $1,000 in 1994. Under Petitioner's view, both of these contributions, if made in 1993 and 1994 respectively, must be made in cash. But if Company A chooses to contribute $2,000 in noncash property in 1993, $1,000 of this contribution would not be in satisfaction of any liability because the funding obligation under Code § 412 had not yet arisen. Indeed, since the funding obligation in a future year will depend on (i) investment performance of the trust's other assets, (ii) services provided by employees, and (iii) whether the employer chooses to terminate the plan, the liability in 1994 might never arise.

Petitioner agreed in the Fifth Circuit that any contribution in excess of a current funding obligation was not a prohibited "sale or exchange." Reply Brief for the Appellant at 9 n.2. The court then concluded that Petitioner's

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[5] Code § 412(a) states that "[a] plan to which this section applies shall have satisfied the minimum funding standard for such plan for a plan year if as of the end of such plan year, the plan does not have an accumulated funding deficiency."

distinction between "voluntary" and "involuntary" contributions was economically irrational because there is no reason why Congress would distinguish between contributions that satisfy a current funding obligation and contributions that increase the employer's funding standard account but do not satisfy a current funding obligation. *Keystone Consolidated Industries v. Commissioner*, 951 F.2d 76, 78 (5th Cir. 1992).

Petitioner now states in footnote 6 of her brief that the Fifth Circuit's conclusion that the voluntary/involuntary distinction was economically irrational, "while relevant to defined benefit pension plans," ignores the fact that contributions to certain types of defined contribution plans do not have the effect of reducing a future funding obligation and are therefore truly "voluntary." Pet. Br. at 6 n.6. Petitioner's statement is ambiguous. Perhaps Petitioner now believes that all contributions to a defined benefit plan are a prohibited "sale or exchange" because even a contribution in excess of a current funding obligation is likely to satisfy a future funding obligation. Alternatively, Petitioner might be arguing, as she did before the Fifth Circuit, that a contribution to a defined benefit plan in excess of a current funding obligation would be a "voluntary" contribution.[6]

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[6] Petitioner also argues that "voluntary" contributions to defined benefit pension plans are "largely a nonissue" since such contributions (whether in cash or other property) are subject to a 10-percent excise tax under Code § 4972. Pet. Br. at 24 n.15. The issue here is what Congress intended when it enacted Code § 4975 in 1974. The excise tax imposed by Code § 4972 on

If Petitioner's evolving position now is that no contribution to a defined benefit plan can ever be "voluntary," then she is wrong. The minimum funding standards imposed by Code § 412(a) are based solely on an annual accounting. As stated above, the future liability will never arise if, for example, the plan were terminated or the value of plan assets increased substantially. The assertion that all contributions to defined benefit plans are "involuntary" ignores the fact that, in a real sense, such contributions are not currently required and may never be required.

If Petitioner wishes to continue to argue that contributions to a defined benefit plan in excess of a current funding obligation are "voluntary" contributions, then her assertion in footnote 6 that some contributions to defined contribution plans are truly "voluntary" misses the point. If Congress had intended to prohibit an employer from meeting a current funding obligation with a contribution of noncash property, there is no reason

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"voluntary" contributions to a defined benefit plan was not enacted until 1986 and was not effective until 1987.

Petitioner's factual assertion that there are no "voluntary" contributions to a defined benefit plan because of Code § 4972 is also inaccurate. Code § 4972 imposes an excise tax only on *nondeductible* contributions. Code § 412, however, contains both minimum funding standards and full funding limitations. A contribution becomes nondeductible only if it exceeds the full funding limitation. An employer thus can make a deductible contribution greater than its minimum funding requirement while still within its full funding limitation. Such a contribution, under the Petitioner's view, would be "voluntary" and not required to be made in cash even though it is deductible for income tax purposes.

why Congress would permit noncash contributions when such contributions will increase the employer's funding standard account and could thereby reduce the amount of required contributions in future years. The fact that there can also be "voluntary" contributions to a defined contribution plan does not explain why Congress would treat "voluntary" and "involuntary" contributions to a defined benefit plan differently.

At bottom, this whole discussion exemplifies why Petitioner's interpretation of Code § 4975 cannot be right. Because (i) the income tax laws do *not* distinguish between "voluntary" and "involuntary" contributions, (ii) a transfer of property subject to a mortgage is a "sale or exchange" between the transferor and transferee, and (iii) the distinction between a "voluntary" and an "involuntary" contribution is so murky, Petitioner's assertion that Congress focused on the voluntary/involuntary distinction in drafting Code § 4975(c)(1)(A) and Code § 4975(f)(3) is incredible. If Congress had focused on this distinction, surely there would be some express indication of the distinction in the statutory language or legislative history. Absent some indication in the statute or legislative history that Congress intended that an "involuntary" contribution of property would be a prohibited "sale or exchange" between an employer and a plan, while a "voluntary" contribution would be merely a "sale or exchange" between the employer and its employees, it is absurd for Petitioner to assert that Congress drafted Code § 4975(f)(3) based on that distinction.

D. Petitioner's Analogy To The Income Tax Laws Is Inapposite. Code § 4975 Imposes An Excise Tax

The Internal Revenue Code requires a taxpayer to recognize gain or loss on a disposition of property when the disposition occurs in a "sale or exchange." Code § 1001(c). Because the finding of a "sale or exchange" is essential to the recognition of gain or loss, courts have interpreted the words "sale or exchange" broadly. For example, under the income tax case law, *any* transfer of property (whether or not in satisfaction of a funding requirement) from an employer to a pension trust is a "sale or exchange." *See, e.g.*, *Tasty Baking Co.*, 393 F.2d at 995; *A.P. Smith Mfg. Co.*, 364 F.2d at 838; *General Shoe Corp.*, 282 F.2d at 12; *International Freighting Corp.*, 135 F.2d 310. When an employer contributes property to a plan, the employer is entitled to a deduction in an amount equal to the fair market value of the property at the time of the contribution. Code § 404(a). If the contribution were not treated as a "sale or exchange" for income tax purposes, the employer's taxable income would either be overstated or understated, depending on whether the property had appreciated or depreciated in value at the time of the contribution.

In contrast to the income tax rules, Code § 4975 does not purport to measure or tax economic income. Code § 4975 was enacted as part of ERISA to prevent "specific prohibited transactions" by making them subject to heavy penalty taxes. H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 321 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5101. Since the legislative purpose of Code § 4975 is so unrelated to the policies behind the income tax rules, the

definition of a "sale or exchange" under the income tax laws is of little relevance when interpreting Code § 4975. Indeed, this Court has stated unequivocally that the word "sale" has many meanings under the Internal Revenue Code, depending on the statutory purpose for that use. *Helvering v. Hammel*, 311 U.S. 504, 507 (1941) ("The term sale may have many meanings, depending on the context . . . . The meaning here depends on the purpose with which it is used in the statute and the legislative history of that use.") For example, in *United States v. Davis*, 370 U.S. 65 (1962), this Court held that a division of property pursuant to a voluntary settlement agreement was to be treated as a "sale or exchange" for income tax purposes, even though the same transaction was *not* treated as a "sale or exchange" under the gift and estate tax statutes. *Id.* at 69 n.6 ("In interpreting the particular income tax provisions here involved, we find ourselves unfettered by the language and considerations ingrained in the gift and estate tax statutes.").

Petitioner's analogy to the income tax rules, if applied to Code § 4975, leads to an absurd result. Petitioner's fundamental premise is that a transfer of property in satisfaction of a statutory funding obligation should be treated as a "sale or exchange" of that property because the transfer relieves the employer of an "indebtedness." Summarizing her position, she states:

> At the least, the contribution of property in satisfaction of a funding obligation is a type of sale of the property. It is equally surely a form of exchange, since the property is exchanged for

diminution of the employer's funding obligation.

Pet. Br. at 17.

Petitioner's definition of a "sale or exchange" cannot be what Congress intended. *Money is property.* Code § 4975(f)(4), in fact, refers on two occasions to "money and the fair market value of the *other* property" (emphasis added). If, therefore, the "contribution of property in satisfaction of a funding obligation is a type of sale of the property" within the meaning of Code § 4975, a contribution of cash in satisfaction of a funding obligation would be a prohibited "sale or exchange."

Petitioner's position is not improved by inserting the word "noncash" before the word "property." The rationale underlying her interpretation of a "sale or exchange" applies equally to both cash and noncash property. Under Petitioner's interpretation of Code § 4975(c)(1)(A), a contribution of "property" in satisfaction of a statutory funding obligation is a "sale or exchange" because the pension plan gives up its right to collect a contribution in an "exchange." If an employer transfers cash to comply with a statutory funding obligation, the employer has engaged in "a form of exchange, since the property is exchanged for diminution of the employer's funding obligation." Pet. Br. at 17. The plan gives up its legal right to a contribution regardless of whether the employer contributes cash or noncash property.[7]

[7] Whether the satisfaction of a debt with cash would constitute a "sale or exchange" under the income tax laws is generally irrelevant because the tax basis of cash is always equal to its fair market value. Therefore no gain or loss would ever be recognized. The issue here, however, is whether a contribution of property constitutes a "sale or exchange," not whether an employer should recognize gain or loss on a contribution. Given that Code § 4975 treats money as "property," a contribution of property cannot be a "sale or exchange."

The fact that Petitioner's interpretation of a "sale or exchange" applies equally well to cash and noncash property demonstrates that Congress did not enact Code § 4975(c) to regulate contributions to pension plans. Congress enacted Code § 4975 to prevent an insider from *extracting* assets from a pension plan, not to prevent an insider from *contributing* assets to a pension plan. *See* Edward A. Zelinsky, *Pensions and Property Contributions: Wood, Keystone, and the Supreme Court*, 56 Tax Notes 651, 656 (1992). Consistent with that purpose, each of the prohibited transactions listed in Code § 4975(c) is a transaction that could allow an employer to extract assets from a pension trust after those assets have been contributed. For example, if an employer sells property to a pension trust in an ordinary "sale or exchange," the trust must transfer assets that it had previously received in exchange for the property. By contrast, a contribution of property, whether cash or noncash, represents an infusion of assets into the plan, not the extraction of assets from a plan.

II. CODE § 4975 IS A PENALTY TAX THAT APPLIES ONLY IF THE WORDS OF THE STATUTE "PLAINLY IMPOSE IT"

A. Code § 4975 Must Be Strictly Construed

Code § 4975 is a penal statute that imposes harsh sanctions against employers that violate its provisions. As

Petitioner states, the statute imposes a "heavy, two-tier tax," Pet. Br. at 13, consisting of a 5% first-tier tax and a 100% second-tier tax. These taxes make "illegal per se" each of the prohibited transactions. *Donovan v. Cunningham*, 716 F.2d 1455, 1464-65 (5th Cir. 1983), *cert. denied*, 467 U.S. 1251 (1984). *See also Nieto v. Ecker*, 845 F.2d 868, 874 n.6 (9th Cir. 1988) (Code § 4975 imposes a "civil penalty"). In this case, the civil penalty imposed by Code § 4975 is staggering. Petitioner has assessed approximately $4 million in penalties under the first-tier tax and approximately $9 million under the second-tier tax. In contrast, the maximum criminal penalty for a corporation under ERISA is $100,000. ERISA § 501, 29 U.S.C. 1131.

Statutes imposing penalty taxes must be given a strict construction. In *Commissioner v. Acker*, 361 U.S. 87, 91 (1959), this Court said:

> We are here concerned with a taxing Act which imposes a penalty. The law is settled that "penal statutes are to be construed strictly," *Federal Communications Comm'n v. American Broadcasting Co.*, 347 U.S. 284, 296, and that one "is not to be subjected to a penalty unless the words of the statute plainly impose it," *Keppel v. Tiffin Savings Bank*, 197 U.S. 356, 362.

This Court relied on *Acker* as recently as last term in giving a narrow construction to a $200 penalty tax imposed on any manufacturer "making" a "firearm." *United States v. Thompson/Center Arms Ço.*, 112 S.Ct. 2102, 2110 (1992).

Respondent believes that Code § 4975 "plainly" *permits* noncash contributions of unencumbered property. The Fifth Circuit and the Tax Court agreed, ruling that a

"contribution" in satisfaction of a statutory funding obligation is not a prohibited "sale or exchange" between an employer and a plan. Both courts reached that conclusion without relying on the requirement that courts must construe penal provisions strictly. The fact that both the Fifth Circuit and the Tax Court ruled for Respondent without applying a narrow construction of Code § 4975 demonstrates that Code § 4975 does not "plainly impose" a penalty tax on contributions of unencumbered property.

Petitioner argues that a "contribution" of property clearly is a prohibited "sale or exchange" since the statute prohibits any "direct or indirect" sale or exchange. No case, however, even under the broadly interpreted income tax laws, has ever suggested that the contribution of property from an employer directly to a pension plan constitutes an "indirect" sale or exchange. Rather, every case interpreting the term "indirect" under the income tax laws, symmetry with which the Petitioner finds essential, has held that an "indirect" transaction is a transaction effected through an intermediary such as a broker, stock exchange, or straw man. *See, e.g., McWilliams v. Commissioner*, 331 U.S. 694 (1947); *Shethar v. Commissioner*, 28 T.C. 1222 (1957); *Estate of Estroff v. Commissioner*, 47 T.C.M. (CCH) 234 (1983).[8] The two references in the legislative history of Code § 4975 to an "indirect" transaction adopt a similar interpretation, describing an "indirect"

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[8] These courts are always careful to point out that the definition of an "indirect" sale or exchange may not be strictly limited to a sale through an intermediary. However, an actual sale through an intermediary appears to be the only type of "indirect" sale ever identified in the case law.

transaction as a transaction effected through a middleman or a related party.[9] Petitioner should not be able to impose $13 million in penalties against Respondent based on an interpretation of the word "indirect" that lacks any support in either case law or legislative history.

B. Petitioner Has Admitted That A Contribution Of Property To A Defined Benefit Plan Is Not A Prohibited Transaction

Any assertion by Petitioner that Code § 4975 "plainly" applies to a contribution of property is outrageous. Petitioner has acknowledged in her own words that the statutory language is, at a minimum, highly ambiguous. In 1978, an employer sought a private ruling from Petitioner that the contribution of noncash property was not a prohibited transaction under Code § 4975. Petitioner, who was authorized at that time to issue regulations under Code § 4975,[10] responded that "the question

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[9] The Conference Report describes two "indirect" transactions. The first such transaction is the sale of property by an employer to a mutual fund under an arrangement in which the employer's pension plan would then invest in the mutual fund. The legislative history refers to this as an "indirect" sale. The second example is a pension plan that invests in a joint venture that owns an office building and leases it to the employer who set up the pension plan. The legislative history refers to this as an "indirect" lease. H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 309-10 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5089-90. These two examples demonstrate that an "indirect" transaction is a transaction through an intermediary.

[10] Regulatory authority under Code § 4975(c) was transferred from the Department of Treasury to the DOL at the end of 1978. Section 102 of Reorganization Plan No. 4 of 1978, 92 Stat. 3790.

of whether the contribution of property other than cash by an employer to his plan constitutes a prohibited transaction as defined by section 4975(c)(1) of the Code, presents an issue that cannot reasonably be resolved prior to the issuance of regulations." Private Letter Ruling 7852116 (Sept. 29, 1978).

Even though Petitioner never promulgated any regulations, Petitioner later "resolved" the issue. Until late 1989 the chapter of the Internal Revenue Manual dealing with contributions of property to *defined benefit plans* stated as follows:

> If the plan requires that cash be contributed, then the contribution of property would constitute a sale or exchange, and hence a prohibited transaction. However, if the plan permits the contribution to be made in cash or in kind *no prohibited transaction would occur.* (Note special rules under 4975(f)(3) of the code for encumbered property).

Internal Revenue Manual, Employee Plans Examination Guidelines Handbook, 7(10)(54) § 324.1(2) (July 15, 1988) (emphasis added) (attached as Appendix A). The Internal Revenue Manual is Petitioner's internal policy manual, available to the public, that is designed to inform revenue agents of Petitioner's administrative positions. Thus, at the same time that Petitioner was seeking $13 million in penalties against Respondent because of a contribution of noncash property to a defined benefit plan, Petitioner was notifying the revenue agents who audit employers that a contribution of noncash property to a defined benefit plan was *not* a "sale or exchange."

Petitioner made a minor adjustment in the Internal Revenue Manual in late 1989. The text *currently* reads:

> If the plan requires that cash be contributed, then the contribution of property would constitute a sale or exchange, and hence a prohibited transaction. However, even if the plan permits the contribution to be made in cash or in kind a prohibited transaction *may* still occur. (Note special rules under 4975(f)(3) of the code for encumbered property).

Internal Revenue Manual, Employee Plans Examination Guidelines Handbook, 7(10)(54) § 324.1(2) (August 24, 1989) (emphasis added) (attached as Appendix B). At a later point in the Manual, Petitioner explains her interpretation of Code § 4975(f)(3) and then explains what she means by the word "may." Petitioner states:

> If a disqualified person transfers real or personal property to a plan, that transfer constitutes a sale or exchange such as to make the transfer a prohibited transaction if:
>
> (1) the property is subject to a mortgage or lien which the plan assumes; or
>
> (2) the plan takes the property subject to a mortgage or similar lien which was placed on the property by a disqualified person within 10 years prior to the transfer. [IRC 4975(f)(3)]
>
> Such a transfer of real or personal property will most often arise in the context of a contribution of property other than cash by the employer. It should be noted that the issue of whether a contribution of property, even though unencumbered, by an employer constitutes an exchange within the definition of a prohibited transaction, *has not yet been decided by the Service.*

Internal Revenue Manual, Employee Plans Examination Guidelines Handbook, 7(10)(54) § 723 (July 15, 1988) (emphasis added) (attached as Appendix C). The *current* version of the Internal Revenue Manual thus states that Petitioner has not yet decided the correct result in this case.

Respondent acknowledges that the Internal Revenue Manual is not legally binding on Petitioner. The issue here, however, is whether the statutory language is sufficiently unambiguous to justify $13 million in penalties. Because Petitioner herself admits that the statutory language is confusing and in fact offered the same interpretation as Respondent until 1989, the statutory language obviously does not so justify. If Petitioner now believes that policy considerations compel her to assert that noncash contributions should be prohibited, Petitioner should go to Congress with those concerns or should issue regulations under Code § 412 requiring cash contributions (on a prospective basis in compliance with the Administrative Procedure Act). Under no circumstances, however, should Petitioner be permitted to regulate retroactively to the detriment of one particular taxpayer.

III. PETITIONER'S BROAD INTERPRETATION OF CODE § 4975 FINDS NO SUPPORT IN LEGISLATIVE HISTORY, POLICY OR AGENCY "INTERPRETATION"

A. The Legislative History Of Code § 4975 Expresses No Intention To Treat A Contribution Of Property As A Prohibited "Sale Or Exchange"

Prior to the enactment of ERISA, the contribution of noncash property to pension plans was common. Petitioner argued that such contributions should not be deductible, but lost the issue and then acquiesced. *Colorado Nat'l Bank v. Commissioner*, 30 T.C. 933 (1958), *acq.*, 1959-1 Cum. Bull. 3; Rev. Rul. 73-345, 1973-2 Cum. Bull. 11; Rev. Rul. 75-498, 1975-2 Cum. Bull. 29. The Internal Revenue Manual, in fact, states that contributions of noncash property still are common today. Internal Revenue Manual, Employee Plans Examination Guidelines Handbook, 7(10)(54) § 324.3(1) (Jan. 30, 1989) ("employers will often transfer stock, bonds, mortgages, and other personal property or real property directly to the trust").

If Congress had intended to change pre-ERISA practice, Congress would have expressed its intent in legislative history. This Court consistently has refused to interpret statutory language so as to effect a major change in law "that is not the subject of at least some discussion in the legislative history." *Dewsnup v. Timm*, 112 S. Ct. 773, 779 (1992); *see also Finley v. United States*, 490 U.S. 545, 554 (1989) (changes in law are not to be inferred unless such intent is clearly expressed). A change in the type of property that an employer can contribute to a

defined benefit pension plan constitutes a "major change" that would warrant some explicit mention in the legislative history. No such mention exists.

The Conference Report for ERISA is divided into fourteen sections. Section IV is labelled "FUNDING." H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 282 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5063. Nothing in Section IV in any way suggests that an employer must meet its funding responsibilities with cash contributions. Section V is labelled "FIDUCIARY RESPONSIBILITY" and includes a description of the prohibited transaction rules. *Id.* at 294, *reprinted in* 1974 U.S.C.C.A.N. at 5075. Again, nothing in Section V suggests that Congress intended to prohibit noncash contributions.[11] To the contrary, in at least two places Section V demonstrates that Congress did not intend for the words "sale or exchange" to include a "contribution."

As explained earlier, the legislative history of Code § 4975(f)(3) states that the purpose of that provision was to prevent an employer from disguising a sale of property by mortgaging that property and then contributing it to the plan. H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 308 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5088. No mention is made of a different rule for contributions to a defined benefit plan. The fair and logical reading of this

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[11] The House and Senate Reports contain nearly identical divisions. H.R. Rep. No. 533, 93rd Cong., 1st Sess. (1973), *reprinted in* 1974 U.S.C.C.A.N. 4639; S. Rep. No. 383, 93rd Cong., 1st Sess. (1973), *reprinted in* 1974 U.S.C.C.A.N. 4890. Nothing in either Report suggests that Congress intended to prohibit noncash contributions.

legislative history is that Congress did not intend to change settled practice with respect to contributions of unencumbered property to defined benefit plans.

The legislative history of Code § 4975(c)(1)(B) is equally irreconcilable with Petitioner's position. Code § 4975(c)(1)(B) states that it is a prohibited transaction for an employer to engage in the "lending of money" with a plan. According to the legislative history, one purpose of this rule was to prevent employers from satisfying their funding obligations to a plan with a promissory note since the employer would then be indebted to the plan. H.R. Conf. Rep. No. 1280, 93rd Cong., 2d Sess. 308 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5088. A promissory note is noncash property. If Congress intended to create a "categorical" rule that a contribution of noncash property was a prohibited "sale or exchange," this legislative history makes no sense. A contribution of a promissory note would be a prohibited transaction under Code § 4975(c)(1)(A) regardless of Code § 4975(c)(1)(B).[12]

B. The Existing Statutory Structure Adequately Addresses Petitioner's Policy Concerns

Petitioner argues that contributions of noncash property create an opportunity for employers to take advantage of pension plans by overstating the value of those contributions. The existing statutory scheme, however,

[12] The fact that it is a prohibited transaction under Code § 4975 for an employer to contribute its own notes to a plan is entirely consistent with the rule that such contributions are *not* deductible under Code § 404. *Don E. Williams Co. v. Commissioner*, 429 U.S. 569 (1977).

directly addresses the concerns raised by Petitioner. If an employer contributes property to a plan to satisfy its minimum funding obligation and the employer overstates the value of those contributions, Petitioner can impose penalty taxes against the employer under Code § 4971 because the plan would have an accumulated funding deficiency. In addition, to the extent that the plan's funding level was then inadequate, the employer's statutory obligations in subsequent years would be increased.

Petitioner also argues that contributions of noncash property interfere with the trustee's right to select the investment assets of the pension trust. This is incorrect. The trustee has the authority to refuse to take title to any contributed property. *See* Pet. Br. at 19 n.11. If the trustee disapproves of the property that the employer wants to contribute, the trustee can refuse to accept it. The employer then must contribute other noncash property or cash. As an alternative, the trustee can accept the property and then sell it. Permitting an employer to contribute noncash property thus does not interfere with the trustee's right to select the trust's investments.

Petitioner's final policy argument is that contributions of noncash property effectively transfer the expenses of selling property to the trust from the employer. Again, this is inaccurate. Any expenses or commissions paid by the trust when selling contributed property will reduce the fair market value of trust assets and thus increase the employer's funding obligations under Code § 412. The employer, not the trust, thus bears the economic cost of selling property.

There are several policy reasons why Congress would *permit* noncash contributions. Defined benefit plans offer far more economic protection to employees than defined contribution plans because the investment risk of a defined benefit plan rests with the employer. *See* Edward A. Zelinsky, *Pensions and Property Contributions: Wood, Keystone and the Supreme Court*, 56 Tax Notes 651, 657 (1992). To the extent property declines in value the employer, not the employees, bears the economic burden. If noncash contributions to defined benefit plans are prohibited but are permitted with respect to plans where the employer has complete discretion whether to make contributions, employers would have an incentive to terminate their defined benefit plans and would adopt, for example, profit-sharing plans or similar plans that offer little retirement security.

Banning noncash contributions also would make it more difficult for employers to make their contributions. If an employer were strapped for cash and bank credit were unavailable, it certainly would be reasonable for Congress to prefer that the employer make the contribution in noncash property rather than not at all. To the extent that the employer attempts to overvalue the contributed property, Petitioner can assess a penalty tax under Code § 4971 and the employer's required contributions in later years would be greater.

Policy considerations in this case thus cut both ways. If Petitioner, the DOL and the Pension Benefit Guaranty Corporation believe that policy considerations now favor prohibiting noncash contributions, they should allow Congress to weigh the different considerations and then make a judgment. *See Chevron, U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 864 (1984) (policy arguments "are more properly addressed to legislators or administrators, not to judges"). And where the meaning of a statute is clear, as it is here, policy considerations are irrelevant. *See Badaracco v. Commissioner*, 464 U.S. 386, 398 (1984).

C. This Court Should Not Defer To The Administrative Views Of The Petitioner And The Department Of Labor. Those Views Have Never Been Expressed In Regulations Or Published Rulings, Are Internally Inconsistent, And Are Based On A Faulty Premise

Petitioner argues that this Court should defer to her interpretation of Code § 4975 and the DOL interpretation of ERISA § 406, 29 U.S.C. 1106. These positions, however, have never been expressed in any published regulation or ruling and are internally inconsistent. Any deference would therefore be inappropriate.

When Congress enacted Code § 4975 in 1974, as noted above in footnote 10, regulatory authority rested with Petitioner. Petitioner chose not to issue regulations on whether a contribution of property was a prohibited transaction. Moreover, Petitioner has never published a single ruling, either public or private, treating a transfer of noncash property to a defined benefit plan as a prohibited transaction. The lone private ruling, as cited above, concluded that the issue could not be resolved without regulations. Private Letter Ruling 7852116 (Sept. 29, 1978).

Petitioner later published guidance for her revenue agents in the Internal Revenue Manual. As explained above, that guidance contradicts Petitioner's position in this litigation. Respondent believes it is an abuse of process for Petitioner to assert penalty taxes as a result of a 1983 transaction when Petitioner was advising her own revenue agents through 1989 that a "contribution" of unencumbered property to a defined benefit plan was not a prohibited "sale or exchange."[13]

Petitioner also suggests that this Court should show deference to the interpretation of the DOL. Again, this Court owes no such deference. As with Petitioner, the DOL has never acted on its authority to issue regulations.[14] The only views offered by the DOL of the term

[13] Petitioner cites two revenue rulings under Code § 4941, not Code § 4975, and states that these rulings are "instructive." Pet. Br. at 31. In those rulings the IRS ruled that a transfer of property to a private foundation in repayment of a loan from the private foundation was a prohibited "sale or exchange." Rev. Rul. 81-40, 1981-1 Cum. Bull. 508; Rev. Rul. 77-379, 1977-2 Cum. Bull. 387. In both rulings property was transferred to repay a *loan* from the private foundation. Employer contributions to a pension plan are governed by an existing statutory scheme that in no way imposes an obligation to make cash contributions and in fact permits contributions of property unless the property is mortgaged. The repayment of a loan from a private foundation, however, is not covered by any statutory scheme and presumably involves a loan agreement under which the debtor agrees to repay the debt in cash.

[14] ERISA § 406(a)(1)(E), 29 U.S.C. 1106(a)(1)(E), treats as a prohibited transaction the acquisition by a plan of "any employer security or employer real property." ERISA §§ 407, 29 U.S.C. 1107, and 408, 29 U.S.C. 1108, provide exceptions to § 406 for certain acquisitions of qualifying employer real property or

"sale or exchange" have come in the form of two unpublished advisory opinions, one of which was released after this litigation began. DOL Advisory Opinions 90-05A (March 29, 1990) and 81-69A (July 28, 1981). These advisory opinions are binding only on the parties thereto and do not have precedential effect. ERISA Procedure 76-1 § 10, 41 Fed. Reg. 36,281, 36,283 (1976). Given the Petitioner's statements in the Internal Revenue Manual, it seems that Petitioner found the DOL opinions unconvincing and chose to ignore them. As this Court recently stated, inconsistent positions of government agencies merit no deference. *See Estate of Cowart v. Nicklos Drilling Co.*, 112 S. Ct. 2589, 2597 (1992).

In these advisory opinions the DOL assumed that ERISA imposes an obligation to make cash contributions. In DOL Advisory Opinion 90-05A, for example, the DOL stated that "contributions in kind that relieve an employer of an obligation to make cash contributions . . . are prohibited exchanges under section 406(a)(1)(A)." The DOL apparently did not understand that there is no "obligation to make cash contributions." Nothing in ERISA requires that an employer contribute cash. The DOL's interpretation thus is circular. The agency believes that an employer must make cash contributions because noncash contributions are prohibited transactions. It

qualifying employer securities. The DOL issued regulations in 1980 under ERISA § 408 defining the term "acquisition" to include purchases, exchanges, *and* contributions, among others. 29 C.F.R. § 2550.408e(b) (1992). Thus, the DOL's regulations under ERISA § 408 distinguish between contributions on the one hand and purchases and exchanges on the other hand.

believes that noncash contributions are prohibited transactions because the employer must make cash contributions. As is the Petitioner, the DOL is hopelessly confused.

CONCLUSION

Code § 4975 imposes a penalty tax that must be strictly construed; its harsh sanctions cannot apply unless the words of the statute "plainly impose it." The words of the statute do not "impose it." To the contrary, Code § 4975 and the statutory provisions governing pension plan funding plainly permit an employer to contribute noncash property to a plan unless the property is mortgaged. The judgment of the Court of Appeals should be affirmed.

Dated: December 23, 1992

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APPENDIX A

Chapter 300
Detailed Techniques – Defined Benefit Plans

324 (2-13-81) 7(10)54
Contributions in the Form of Other Property

324.1 (7-15-88) 7(10)54
General

(1) When an employer makes a contribution in the form of property other than cash, all elements of the transaction should be carefully scrutinized by the specialist. There are numerous violations, including prohibited transactions, in this area. These violations occur not only with regard to the fair market value (FMV) of the property claimed as a deduction, but also as to whether the transferred asset is an acceptable investment for an exempt employees trust. The specialist should check Form 5500 or 5500C to see if there is an indication that payments were made in assets other than cash or its equivalent.

(2) Contributions are generally required to be made in cash. The plan provisions pertaining to employer contributions are controlling as to whether a contribution has to be in cash. If the plan requires that cash be contributed, then the contribution of property would constitute a sale or exchange, and hence a prohibited transaction. However, if the plan permits the contribution to be made in cash or in kind no prohibited transaction would occur. (Note special rules under 4975(f)(3) of the code for encumbered property.) Example: Corporation XYZ maintains a qualified profit sharing plan. The plan permits contributions to be made in cash or in kind contributions.

On April 5, 1988 Corporation XYZ contributes 100 shares of ABC stock to the profit sharing plan. ABC stock is traded on the New York Stock Exchange and on April 5, 1988 it traded at 10.00 a share unchanged. This would not constitute a prohibited transaction for purposes of 4975 of the code.

(3) Finally, anytime an employer contributes overvalued property and takes a deduction for the claimed value IRC 404 would also be implicated.

APPENDIX B

Chapter 300
Detailed Techniques – Defined Benefit Plans

324 (2-13-81) 7(10)54
Contributions in the Form of Other Property

324.1 (8-24-89) 7(10)54
General

(1) When an employer makes a contribution in the form of property other than cash, all elements of the transaction should be carefully scrutinized by the specialist. There are numerous violations, including prohibited transactions, in this area. These violations occur not only with regard to the fair market value (FMV) of the property claimed as a deduction, but also as to whether the transferred asset is an acceptable investment for an exempt employees trust. The specialist should check Form 5500 or 5500C to see if there is an indication that payments were made in assets other than cash or its equivalent.

(2) Contributions should generally be made in cash. The plan provisions relating to employer contributions are pertinent as to whether a contribution has to be in cash. If the plan requires that cash be contributed, then the contribution of property would constitute a sale or exchange, and hence a prohibited transaction. However, even if the plan permits the contribution to be made in cash or in kind a prohibited transaction may still occur. (Note special rules under 4975(f)(3) of the code for encumbered property.) See (10)54 of LEM VII.

(3) Finally, anytime an employer contributes overvalued property and takes a deduction for the claimed value IRC 404 would also be implicated.

APPENDIX C

Chapter 700
Qualified Trusts – Activities

723 (7-15-88) 7(10)54
Identifying the Prohibited Transaction

(1) The specialist should inspect the plan records to ascertain if any of the following transactions have taken place directly or indirectly between the plan and a disqualified person:

(a) Sale, exchange, or lease of any property, (See 723:(2));

(b) Loans or extensions of credit, (See 723:(3));

(c) Furnishing goods, services or facilities, (See 723:(4));

(d) Transfer to, or use by or for the benefit of, a disqualified person of any income or assets of the plan, (See 720.3:(5));

(e) Dealings by a fiduciary with the income or assets of the plan for his/her own interest;

(f) Receipt by a fiduciary of any consideration, from a party dealing with the plan in connection with a transaction involving income or assets of the plan, (See 720.3:(6) and (7)); or

(g) Acquisition and holding of employer securities or real property (See 720.3:(8)).

(2) Sale, exchange or leasing of property:

(a) The specialist should inspect the plan records to ascertain whether there have been any sales,

exchanges or leases of property. If such a transaction has occurred the specialist should request back-up documents to determine if the transaction is prohibited. Documents which might be examined to ascertain whether a prohibited transaction has occurred include, but are not limited to: purchase-sales agreements, mortgages, land contracts, liens, deeds, lease and rental agreements and brokerage statements.

(b) The sale, exchange or leasing of property, directly or indirectly, between a disqualified person and the plan constitutes a prohibited transaction whether the transaction was made from disqualified person to the plan or from the plan to the disqualified person.

(c) If a disqualified person transfers real or personal property to a plan, that transfer constitutes a sale or exchange such as to make the transfer a prohibited transaction if:

1 the property is subject to a mortgage or lien which the plan assumes; or

2 if the plan takes the property subject to a mortgage or similar lien which was placed on the property by a disqualified person within 10 years prior to the transfer. [IRC 4975(f)(3)]

Such a transfer of real or personal property will most often arise in the context of a contribution of property other than cash by the employer. It should be noted that the issue of whether a contribution of property, even though unencumbered, by an employer constitutes an exchange within the definition of a prohibited transaction, has not yet been decided by the Service.

(8)

No. 91-1677

In the Supreme Court of the United States

OCTOBER TERM, 1992

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

WILLIAM C. BRYSON
Acting Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

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In the Supreme Court of the United States

OCTOBER TERM, 1992

No. 91-1677

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

Nothing in respondent's brief demonstrates any error in our contention that the transfer of property in satisfaction of a funding obligation is a "sale or exchange" within the meaning of Section 4975(c)(1)(A). Accordingly, that provision prohibited respondent from satisfying its funding obligations by transferring truck terminals and real estate to the Pension Trust, rather than paying in cash.[1]

[1] Respondent does not acknowledge that there is anything unusual about its form of payment. But most persons would be quite surprised (and would almost surely raise objections) if a debtor suggested that, instead of paying in cash, it would satisfy an obligation by transferring ownership of a truck terminal or a parcel of real estate.

A. *An employer's transfer of property in satisfaction of its funding obligation is a "sale or exchange" of the property.*

1. Respondent contends that "sale or exchange" is interpreted broadly under the income tax provisions of the Code "[b]ecause the finding of a 'sale or exchange' is essential to the recognition of gain or loss." Br. 24. Hence, according to respondent, the fact that a transfer of property in satisfaction of an obligation is a "sale or exchange" of the property under the income tax provisions of the Code has "little relevance" (Br. 25) under Section 4975.

Contrary to respondent's premise, gain or loss ordinarily is recognized on "the sale *or other disposition* of property," not simply dispositions constituting sales or exchanges of property. 26 U.S.C. 1001(a) (emphasis added). Nor were the many decisions of the courts over the last fifty years holding that a transfer of property in satisfaction of an obligation constitutes a "sale or exchange" based on an unusually broad interpretation of that phrase. Those decisions clearly comport with the well established rule that the words "sale" and "exchange" as used in the Internal Revenue Code are to be given their "ordinary meaning." *Helvering* v. *Flaccus Leather Co.*, 313 U.S. 247, 249 (1941); see also *Commissioner* v. *Soliman*, No. 91-998 (Jan. 12, 1993), slip op. 5 ("[i]n interpreting the meaning of the words in a revenue act, we look to the ' "ordinary everyday senses" ' of the words").[2]

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[2] *Helvering* v. *Hammel*, 311 U.S. 504 (1941), which respondent cites for the proposition that the word "sale" may have many different meanings (Br. 25), is not to the contrary. In that case, this Court declined to depart from the "usual meaning" of the word "sale" as including gain or loss realized on the foreclosure of property because the "usual meaning" did not produce an absurd result or one that would thwart the obvious purpose of the statute. 311 U.S. at 510-511. Respondent's assertion that this Court held in *United States* v. *Davis*,

The pertinent administrative interpretations similarly have given "sale or exchange" its ordinary meaning under the excise tax provisions of the Internal Revenue Code, including Section 4975(c)(1)(A). See Rev. Rul. 77-379, 1977-2 C.B. 387; Rev. Rul. 81-40, 1981-1 C.B. 508; DOL Advisory Opinion 81-69A (July 28, 1981); DOL Advisory Opinion 90-05A (Mar. 29, 1990). Indeed, the court of appeals in *Wood* v. *Commissioner*, 955 F.2d 908, 913 (4th Cir.), cert. granted, 112 S. Ct. 2937 (1992), cert. dismissed, 112 S. Ct. 3061 (1992), found "no instance when the term 'sale or exchange' has been used or interpreted not to include transfers of property in satisfaction of indebtedness" (Pet. App. 28a), and respondent has cited none.[3]

Nor does respondent plausibly explain why a direct transfer of property to a pension plan in satisfaction of a funding obligation should be treated differently from the transfer of cash to a pension plan, followed by the use of the cash to purchase property from the employer, a transaction that no one disputes would be prohibited by

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370 U.S. 65 (1962), that a division of property was treated as a "sale or exchange" for income tax purposes but "was *not* treated as a 'sale or exchange' under the gift and estate tax statutes" (Br. 25) is incorrect. To be sure, this Court stated in *Davis* that "the language and considerations ingrained in the gift and estate tax statutes" were not relevant under the income tax provisions of the Internal Revenue Code. 370 U.S. at 69 n.6. But that was because whether a transaction is a gift depends on whether the property is transferred for less than an "adequate and full consideration in money or money's worth" (26 U.S.C. 2512(b)), not on whether the transaction is a "sale or exchange" or other type of taxable disposition under the income tax provisions of the Internal Revenue Code.

[3] *See also Commissioner* v. *Brown*, 380 U.S. 563, 570-571 (1965), where this Court stated that "[a] 'sale' * * * is a common event in the non-tax world; and since it is used in the Code without limiting definition and without legislative history indicating a contrary result, its common and ordinary meaning should at least be persuasive of its meaning as used in the Internal Revenue Code."

Section 4975(c)(1)(A). Under respondent's interpretation, however, the prohibition against "sales or exchanges" between employers and pension plans ~~may be circum~~vented by the simple expedient of not paying cash to the plan to satisfy the employer's funding obligation, but instead transferring to the plan the property that the employer desires to sell.[4]

2. Respondent further contends (Br. 8) that, since Section 412 does not state that pension plan contributions must be made in cash, it owed no "monetary" or "dollar" funding obligation to the plan. Hence, according to respondent, its transfers of property to the Pension Trust were not sales or exchanges of the properties transferred, because the transfers were not made in satisfaction of an obligation to transfer cash to the Pension Trust. Respondent cites no authority for the remarkable proposition that a transfer of property in satisfaction of an obligation is not a "sale or exchange" of the property unless the obligation is expressly required to be paid in cash.

In any event, contrary to respondent's assertion, Section 412 clearly states a plan's funding obligation in monetary or dollar terms. Section 412(a) provides that a plan shall have satisfied the minimum funding standard so

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[4] Respondent's citation (Br. 30 n.9) to the "indirect" transactions described in the legislative history underscores the error of respondent's position. For example, as respondent concedes (*ibid.*), an employer's sale of property to a mutual fund under an arrangement in which the plan then invests in the mutual fund is a prohibited transaction. See H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 309-310 (1974). Such a transaction is the functional equivalent of using the plan's money to facilitate the sale of the employer's property. Similarly, the contribution of cash to a pension plan in satisfaction of a funding obligation and the simultaneous use of the cash to purchase property from the employer is the functional equivalent of the sale of the employer's property.

long as the plan does not have an accumulated funding deficiency. Whether a plan has an accumulated funding deficiency is determined by offsetting the various credits to, and charges against, the plan trust. Under Section 412(b), respondent's funding standard account is charged with the "sum" of the "amount[s]" necessary to fund the plan, and is credited with the "sum" of the "amount[s]" transferred to the plan. The terms "sum" and "amount[s]" plainly denote a monetary obligation. Respondent thus was required to fund the Pension Trust so as to satisfy the dollar amount of the obligation it owed to the Trust.

Moreover, it is well established that the transfer of property in satisfaction of an obligation is a sale of the property for the amount of the obligation satisfied, whether the obligation must be paid in cash or whether the debtor has the choice of paying the obligation in cash or transferring property of equivalent value in satisfaction of the obligation. See *Kenan* v. *Commissioner*, 114 F.2d 217, 219-220 (2d Cir. 1940); Rev. Rul. 86-105, 1986-2 C.B. 82, 83; see also *Lakeside Irr. Co.* v. *Commissioner*, 128 F.2d 418, 418-419 (5th Cir.), cert. denied, 317 U.S. 666 (1942). Indeed, the courts of appeals in both this case and *Wood* (Pet. App. 7a, 42a) agreed that the transfer of property to a pension plan in satisfaction of a funding obligation is a "sale or exchange" under the usual meaning of those words.[5]

3. Respondent argues further that "the statutory structure of ERISA" shows that "a 'contribution' of property * * * is not a prohibited 'sale or exchange.'" Br.

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[5] Respondent also argues (Br. 26) that, since money is property, a transfer of money in satisfaction of a funding obligation must be a prohibited sale of the money under the government's interpretation of Section 4975(c)(1)(A). As with many of respondent's contentions, this novel argument overlooks the fact that "sale or exchange" is to be given its ordinary meaning. A transfer of money (*i.e.*, United States currency) in satisfaction of an obligation would not be considered a sale of the money in common usage.

6. According to respondent, matters pertaining to the funding of a defined benefit pension plan are governed by Sections 404 (allowing deductions for plan contributions), 412 (establishing minimum funding obligations), and 4971(a) (imposing an excise tax on funding deficiencies), which permit—or at least do not explicitly prohibit—contributions of property to pension plans. Br. 7-10, 36-39. In respondent's view, the only purpose served by Section 4975 is "to protect the assets of a plan once those assets have been contributed." Br. 11. Thus, according to respondent, Section 4975(c)(1)(A) only "prevents an employer from selling property to a pension plan in exchange for plan assets." Br. 14.

Respondent's restrictive reading of Section 4975 is erroneous. By its terms, Section 4975(c)(1)(A) prohibits "*any* direct or *indirect* * * * sale or exchange * * * of any property between a plan and a disqualified person." The statutory language does not except a transaction that is a "sale or exchange" within the accepted meaning of those words on the basis that the "sale or exchange" occurs in connection with the funding of a plan. Furthermore, respondent's view cannot be squared with Congress's objective in enacting Section 4975, which was to bar categorically transactions that carry a high potential to harm pension plans.[6] Respondent's interpretation of

[6] As we show in our opening brief (at 19-20), this case illustrates one aspect of the potential for abuse, since respondent contributed to the Pension Trust truck terminals that were difficult to sell. Respondent notes (Br. 1) that, in this case, by the time all of the truck terminals were ultimately sold, the plan received net amounts greater in the aggregate than the fair market value of the properties on the dates of contribution. But that does not justify the contribution of illiquid property that took the Trust three and one-half years to sell; respondent placed the risk on the Trust that the property would depreciate in value during that period and shifted the selling costs of the properties to the Trust. Moreover, if respondent had contributed cash to the plan, the plan could have invested it during the time that it was trying to sell the truck terminals. Although, as respondent observes (Br. 37), it may ultimately bear any losses suffered by the plan as a result of respondent's failure to contribute cash, because that cost may eventually be reflected in an increase in its funding obligation, the fact remains that respondent deferred to a future year its obligation to fund the plan to that extent. And as we point out in our opening brief (at 21), if respondent encounters serious financial problems while deferring payment, the shortfall may be borne by the PBGC and plan participants. See also PBGC Amicus Br. at 3-4.

Section 4975(c)(1)(A) would open the door to many of the abuses that Section 4975(c)(1)(A) was intended to prohibit. See *Wood* v. *Commissioner*, *supra*, Pet. App. 23a (rejecting the contention that, under the statutory structure, Section 4975 "applies only to the *operation and management* of a defined benefit plan, and does not pertain to *contributions* of property to fund the plan").

Furthermore, contrary to respondent's contention (Br. 9-10), there is nothing inconsistent in allowing deductions based on the transfer of property in payment of a deductible expense and treating the same transfer of property as a "sale or exchange" of property subject to excise tax under Section 4975. Treasury Regulations explicitly indicate that a contribution of property may pass muster under Section 415 and hence be deductible under Section 404 even though the transaction is a prohibited transaction. See Treas. Reg. § 1.415-6(b)(4). If a tax deduction were not allowed to an employer who transferred property in satisfaction of a funding obligation, that employer would be put in a worse position than one who sold property to a pension trust and then used the proceeds to make a tax deductible contribution to satisfy its funding obligation. As we have argued, there is no reason to distinguish between a direct and an indirect sale. Similarly, Section 412, which establishes minimum funding *standards*, is not addressed to the *manner* in which a pension plan is funded at all, and thus it neither

specifically authorizes nor specifically prohibits contributions of property to pension plans.[7]

Moreover, it is not surprising that the rules set out in 26 U.S.C. 401 *et seq.* do not by their terms punish prohibited transactions. In general, those provisions in the Tax Code govern the tax qualification of pension plans, and Congress did not want pension plans to lose their tax-qualified status, which would have unfavorable consequences for all plan participants, on account of a fiduciary breach such as the sale of property to a plan by an insider such as an employer. See. *e.g.*, H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 321-322 (1974). Other provisions—including the prohibited transaction provisions—are aimed at preventing and correcting fiduciary breaches.

Respondent's reliance on Section 4971 is similarly misplaced. Respondent points out that, since Section 4971

[7] Respondent also asserts (Br. 34) that, since contributions of property to pension plans were common prior to the enactment of ERISA, Section 4975(c)(1)(A) may not be interpreted to prohibit contributions of property in satisfaction of funding obligations absent legislative history indicating an intention to change pre-ERISA law. Unlike the cases on which respondent relies (*Dewsnup* v. *Timm*, 112 S. Ct. 773, 779 (1992); *Finley* v. *United States*, 490 U.S. 545, 554 (1989)), however, ERISA constituted "the most sweeping revision of pension law since pension law began" (J. Sherman, *Pension Planning and Deferred Compensation* § 1.01, at 2 (1985)), and imposed a comprehensive remedial scheme designed to protect the pensions and other benefits of employees (*M&R Investment Co.* v. *Fitzsimmons*, 484 F. Supp. 1041, 1054 (D. Nev. 1980), aff'd, 685 F.2d 283 (9th Cir. 1982)). In any event, the reason a transfer of property in satisfaction of a funding obligation was not prohibited under prior law was that transactions between disqualified persons and pension plans, including sales and exchanges, were restricted only by the requirement that the transaction reflect a fair consideration under an arm's-length standard of dealing between the parties. But, as we show in our opening brief (at 12-13), Congress enacted Section 4975 to replace the arm's-length standard with a set of categorical rules.

imposes an excise tax on accumulated funding deficiencies, it follows that if an employer overstates the value of property contributed to a plan, the employer would be subject to excise tax under Section 4971. Br. 9, 37. According to respondent, it follows that such a transaction must not be one prohibited by Section 4975. But *every* transaction prohibited by Section 4975 *could* cause a funding deficiency if not conducted at arm's-length. Hence, the fact that a transaction could cause a funding deficiency that would be subject to excise tax under Section 4971 provides no basis for determining whether it is prohibited by Section 4975. Moreover, respondent's position would do violence to the purpose of Section 4975—to eliminate the need for case-by-case evaluations of transactions between disqualified persons and pension plans, so as to prevent disqualified persons from inflicting harm on a pension plan before that harm occurs. S. Rep. No. 383, 93d Cong., 1st Sess. 32 (1973).[8]

[8] Respondent also suggests (Br. 10 n.2) that 26 U.S.C. 83, the income tax provision that governs property transferred in connection with the performance of services, contemplates that employers would make non-cash contributions to qualified plans. But that does not undermine our position, because we recognize that unencumbered property may be transferred to defined contribution plans when the transfer does not fulfill a funding obligation. Furthermore, Section 83 ordinarily results in the delay of employer deductions until the value of the property transferred is included in the income of the employee. A principal tax benefit provided to qualified plans, however, is that employer contributions are deductible when made even though the employee is not taxed until he begins receiving retirement benefits. Hence, it is hardly surprising that Congress provided in Section 83(e)(2) that the provision does not apply to transfers of property to or from qualified plans.

Respondent similarly asserts (Br. 12) that, since Section 408(a)(1) specifically prohibits contributions of property to individual retirement accounts (IRAs), the absence of a provision in Section 4975 or elsewhere specifically prohibiting contributions of property to other types of pension plans indicates that Congress did not intend to prohibit

B. Section 4975(f)(3) is not superfluous if "sale or exchange" is given its ordinary meaning.

There is no merit to respondent's argument (Br. 16-19) that Section 4975(f)(3), the provision barring transfers of *mortgaged* property to pension plans, is rendered superfluous by our interpretation of Section 4975(c)(1)(A). As we explain in our opening brief (at 24-26), the primary flaw in that argument is that it overlooks the existence of defined *contribution* pension plans, such as profit-sharing plans. While the contribution of property to a defined *benefit* pension plan, such as the plans sponsored by respondent, is generally a prohibited "sale or exchange" of the property under Section 4975(c)(1)(A),[9] many donations to defined contribution plans do not extinguish any funding obligation. Indeed, some defined contribution plans do not even have funding obligations.

Thus, the donation of property worth, for example, $80,000, to a defined contribution plan is not a prohibited transaction if it is in addition to any funding obligation the employer may have. That is so, even though, under pre-ERISA cases such as *Tasty Baking Co.* v. *United States*, 393 F.2d 992, 995 (Ct. Cl. 1968), the transaction would constitute a "sale or exchange" under the income tax laws, since the property would be contributed in exchange for

transfers of property to such plans. Once again, respondent ignores that the government has never contended that Section 4975 bars all contributions of property to pension plans. Moreover, there are no funding obligations of any kind in the case of IRAs. Thus, Section 408(a)(1) establishes a rule for IRAs that is stricter than the rules that apply to other types of defined contribution plans — property, including unencumbered property, may not be contributed to IRAs, even though the contribution does not satisfy a funding obligation.

[9] The contribution of property to a defined benefit pension plan is not prohibited if the transaction satisfies the exemption requirements for employer real property and securities set out in 26 U.S.C. 4975(d)(13) and 29 U.S.C. 1108(e).

the employees' labor. Whatever the relevance of those cases after the enactment of ERISA, which contains detailed provisions setting out the tax treatment of contributions to qualified pension plans (see 26 U.S.C. 401 *et seq.*), Section 4975(c)(1)(A) does not prohibit sales or exchanges between the employer *and its employees*. Rather, it prohibits sales or exchanges between *pension plans* and sponsoring employers. In other words, a defined contribution plan has not been a party to a "sale or exchange" if an employer contributes property where there is not a funding obligation owed to the plan. Accordingly, Section 4975(f)(3) is not rendered superfluous by our reading of Section 4975(c)(1)(A) since, in our view, Section 4975(f)(3) prohibits contributions of *mortgaged* property even if the contribution does not satisfy a funding obligation and hence is not a prohibited "sale or exchange" under Section 4975(c)(1)(A).

Respondent does not dispute the fact, overlooked by the court of appeals in this case, that defined contribution plans exist and that employers make contributions to those plans that do not satisfy any funding obligation. However, respondent suggests that a contribution of mortgaged property would always constitute a "sale or exchange" between an employer and a plan even in the absence of Section 4975(f)(3), and contends on that basis that Section 4975(f)(3) is rendered superfluous by our reading of the statute. That argument is flawed. For example, if an employer contributed property that was worth $100,000 but subject to a $20,000 mortgage to a defined contribution plan, the net effect would be the same as if the employer contributed property worth $80,000 to a plan. There is no good reason why it should be treated differently for purposes of the prohibited transaction rules. Accordingly, such a contribution would not be barred by Section 4975(c)(1)(A), but it would be barred by Section 4975(f)(3), which provides that the transfer of

mortgaged property by a disqualified person to a plan "shall be treated as a sale or exchange."[10] That, in turn, shows that Section 4975(f)(3) is not rendered superfluous by our reading of Section 4975(c)(1)(A).

Moreover, the language in Section 4975(f)(3) providing that the contribution of mortgaged property "shall be treated as a sale or exchange" undercuts respondent's position. That terminology—"shall be treated as"—is used throughout the Internal Revenue Code to denote special treatment. See, *e.g.*, Sections 165(e), 165(g)(1), 195(b), 291(a), 301(c)(3)(A), 302(a), 303(a), 304(a)(1), 306(a)(1)(B), 331(a), 2044(c), 2518(c)(1)-(3), and 2519(a). (See also "deemed," *e.g.*, Section 1234(a)(2).) Thus, by directing that contributions of mortgaged property "shall be treated as" sales or exchanges, Congress showed that it did not view every contribution of mortgaged property as necessarily *being* a "sale or exchange."

Similarly, the legislative history shows that Congress did not view every contribution of mortgaged property as constituting a "sale or exchange." The committee reports described Section 4975(f)(3) by stating that "[t]his rule prevents circumvention of the prohibition on sale by mortgaging the property before a transfer to the trust." S. Rep. No. 383, 93d Cong., 1st Sess. 98 (1973); see also H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 308 (1974). Congress plainly thought that the contribution of mortgaged property was not, in and of itself, a "sale or

[10] Of course, the amount of the mortgage would be taken into account in determining the proper tax treatment of the contribution by the employer. The cases petitioner cites, *Commissioner* v. *Tufts*, 461 U.S. 300 (1983), and *Crane* v. *Commissioner*, 331 U.S. 1 (1947), support that conclusion, but only that conclusion. Neither case involved a pension plan and neither suggests that the contribution of mortgaged property to a pension plan should always (or ever) be characterized as a "sale or exchange" between the plan and the employer rather than between the employees and the employer.

exchange" between an employer and a plan, since the reports said that, in the absence of Section 4975(f)(3), an employer might be able to "circumvent[ ]" the prohibition on sales. Furthermore, the fact that Congress spoke of "treating" transfers of mortgaged property as sales or exchanges and of avoiding "circumvention" of the prohibition on sales to pension plans by insiders also shows that respondent and the court of appeals err insofar as they contend that Section 4975(f)(3) provides the *definition* of "sale or exchange." Rather, that language shows that Section 4975(f)(3) provides a rule that supplements, rather than replaces, the prohibition set out in Section 4975(c)(1)(A).

Respondent ignores our argument (Br. 27) that, if Congress had wanted to allow employers to satisfy their funding obligations by contributing unencumbered property to pension plans, it would have done so in Section 4975(d), the exemption provision, rather than by negative implication from the "special rule" in Section 4975(f)(3). As we noted, Congress created an exemption for certain employer contributions of property in Section 4975(d)(13). See also 29 U.S.C. 1108(e). This narrow exemption, which is inapplicable here, would have been unnecessary if Section 4975(c)(1)(A) did not generally prohibit contributions of unencembered property.

In short, respondent mistakenly argues that our construction of Section 4975(c)(1)(A) renders Section 4975(f)(3) superfluous and also reads the "special rule" set out in Section 4975(f)(3) out of its context. That provision is a prophylactic measure that keeps mortgaged property from being contributed to pension plans. It cannot be read as the statutory *definition* of "sale or exchange"—which it clearly is not (it is a "special rule"). Moreover, respondent erroneously reads Section 4975(f)(3) in a manner that emasculates Section 4975(c)(1)(A). That is, as we explain in our opening brief (at 26), in respondent's view employers

are free to fulfill their funding obligations by contributing property rather than cash to pension plans, despite the high potential for abuse inherent in such transactions, as long as they do not contribute mortgaged property. Respondent has suggested no reason why Congress would have been so protective of pension plans with respect to encumbered property—barring any such contribution, even those that are plainly beneficial—while at the same time allowing employers to satisfy their funding obligations by contributing unencumbered property despite the fact that such property may be overvalued or difficult to sell or both.[11]

C. The canon of statutory construction that penalty statutes are to be strictly construed has no application to the prohibited transaction rules of Section 4975.

Respondent's contention that Section 4975 should be narrowly construed because it imposes a penalty is refuted by the language of the statute. Section 4975(c)(1) states in the broadest possible terms that "any direct or indirect" transactions of the types described are prohibited. See *McWilliams* v. *Commissioner*, 331 U.S. 694 (1947); see

[11] Respondent also errs in asserting (Br. 36) that Section 4975(c)(1)(B), which, among other things, prohibits disqualified persons from borrowing money from pension plans, shows that our reading of Section 4975(c)(1)(A) is mistaken. According to respondent, since an employer's own promissory note is property, an employer's transfer of its promissory note to a pension plan in satisfaction of a funding obligation would constitute a sale of the note under Section 4975(c)(1)(A); that suggests, respondent continues, that our reading of Section 4975(c)(1)(A) is overbroad, because Section 4975(c)(1)(B) prohibits such borrowing. The primary problem with the argument is that an employer's transfer of its own promissory note to a pension plan is not a payment that satisfies its funding obligation. An employer's own promissory note is simply a promise to pay. *Don E. Williams Co.* v. *Commissioner*, 429 U.S. 569 (1977)

also *Wood* v. *Commissioner*, *supra;* Pet. App. 31a ("the very language of the section indicates that the term 'sale or exchange' should not be interpreted restrictively"). None of the cases on which respondent relies for the general proposition that penalty statutes ordinarily are narrowly construed (Br. 27-28) dealt with a statute whose language shows that it was intended to be broadly construed. Cf. *Russello* v. *United States*, 464 U.S. 16, 29 (1983) (rule of lenity applies only if the court cannot otherwise construe a statute).

Furthermore, construing Section 4975 narrowly would do violence to the purpose of that provision. Section 4975 and its counterpart in the Labor provisions of ERISA were enacted to ensure the integrity of pension plans by eliminating the possibility that transactions between disqualified persons and pension plans might not be at arm's-length, or otherwise might not be in the best interest of the plan. Thus, consistent with the broad language and purpose of the prohibited transaction provisions, the Seventh Circuit held that Section 406 of ERISA (the Labor counterpart of Section 4975 of Internal Revenue Code) should be interpreted "broadly in light of Congress' concern with the welfare of plan beneficiaries." *Leigh* v. *Engle*, 727 F.2d 113, 126 (7th Cir. 1984), on remand, 619 F. Supp. 154 (N.D. Ill 1985), 669 F. Supp. 1390 (N.D. Ill. 1987), aff'd, 858 F. 2d 361 (7th Cir. 1988), cert. denied, 489 U.S. 1078 (1989); see also *M&R Investment Co.* v. *Fitzsimmons*, 484 F. Supp. at 1054. The Seventh Circuit added that, since the entire statutory scheme of ERISA demonstrates Congress's overriding concern with the protection of plan beneficiaries, "we would be reluctant to construe narrowly any protective provisions of the Act." 727 F.2d at 126. A narrow construction of Section 4975 would serve only to benefit insiders who desire to engage in potentially abusive transactions with pension plans at the expense of both plan beneficiaries and the PBGC. The

general canon of construction that penalty statutes are narrowly construed does not override the language of Section 4975(c)(1)(A) and Congress's purpose in enacting it.

In addition, the strict construction principle is simply not applicable where, as here, the tax imposed is one that can easily be avoided. See *Fulman, Inc.* v. *United States*, 434 U.S. 528, 533 n.8 (1978). Respondent could have avoided the excise tax of Section 4975 in this case either by (1) heeding the Department of Labor's 1981 administrative ruling that a transfer of property in satisfaction of a funding obligation is a prohibited sale or exchange (DOL Advisory Opinion 81-69A); or (2) seeking an administrative exemption under the procedures of 29 U.S.C. 1108 and 26 U.S.C. 4975(c)(2). Indeed, the bulk of the excise tax imposed by Section 4975 may easily be avoided even *after* a disqualified person has engaged in a prohibited transaction.[12]

Furthermore, Section 4975 is an excise tax, and has been held *not* to constitute a penalty tax for various tax and non-tax purposes. See *Latterman* v. *United States*, 872 F.2d 564, 568-570 (3d Cir. 1989) (excise tax imposed by Section 4975(a) was not a "penalty," but a "tax," for purposes of applying Section 6601 of the Code, a provision that provides for the accrual of interest on, *inter alia*, underpayments of tax); *In re The Mansfield Tire & Rubber Co.*, 942 F.2d 1055 (6th Cir. 1991), cert. denied *sub nom. Krugliak* v. *United States*, 112 S.Ct. 1165 (1992) (excise taxes imposed by Code Section 4971 are "taxes" rather than "penalties" under the Bankruptcy Code).

[12] The first tier tax is an annual one of five percent of the amount involved. Section 4975(a). The heavier second tier tax of 100% of the amount involved ordinarily may be avoided entirely by timely correction of the transaction after the completion of litigation concerning the taxpayer's liability for that tax. See Sections 4975(b), 4961(a), 4963(b) and (e), 6213(a), 7481(a).

Thus, there is no basis for according "sale or exchange" in Section 4975(c)(1)(A) a narrow construction at odds with the ordinary, long-accepted meaning of those words.

Finally, respondent asserts (Br. 37-39) that the statute should be construed narrowly because the policy concerns of the government are addressed by other provisions, and because there are "several" countervailing policy considerations. Respondent, however, points to only one such purported policy consideration. Thus, respondent asserts that defined benefit plans are better for employees than defined contribution plans, and that, since the contribution of property to a defined contribution plan is not necessarily a prohibited transaction, the Commissioner's position here effectively encourages employers to establish defined contribution plans. But an employer that wishes to use property to satisfy its funding obligation to a defined benefit plan need only sell that property and contribute the cash proceeds to the plan to avoid the prohibited transaction rules. Only if the employer cannot find a buyer for the property will the employer be in a worse position than if it contributed the property directly to the plan (except for having to bear the costs of sale immediately). That, however, merely points up why the contribution of property to a plan in satisfaction of a funding obligation should be a prohibited transaction. Furthermore, respondent's suggestion that other statutes address the policy concerns of the Commissioner is wrong, as has been discussed above (pp. 8-9), and in our opening brief (at 18-21). Indeed, even respondent ultimately is forced to admit (Br. 38) that "[p]olicy considerations in this case * * * cut both ways."

In our view, however, no policy consideration favors respondent. That is, there is no good reason why employers should not generally sell property themselves and contribute the proceeds to satisfy their pension obligations. The contrary rule that respondent favors

would allow employer. to overvalue the property they contribute and transfer the transaction costs of sale to pension plans. Of course, the temptation to do so would be greatest when the employer is encountering financial difficulty, as the PBGC explains in its amicus brief. That, in turn, makes it likely that the PBGC would end up with the burden of converting such property into cash to pay pension benefits, and that the plan would not have the assets required to pay the benefits that were promised.

D. The administrative interpretations of Section 4975 of the Department of Labor and the Internal Revenue Service are entitled to deference.

Respondent's contention that the administrative interpretations of the Department of Labor and the Internal Revenue Service are not entitled to deference is based largely on its assertion that the Internal Revenue Service has not consistently interpreted Section 4975 to prohibit the transfer of property in satisfaction of a funding obligation. Br. 30-33, 39-40. Since 1978, however, the Department of Labor, not the Internal Revenue Service, has had interpretive authority with respect to Section 4975(c) (with the exception of Section 4975(c)(3), dealing with the furnishing of goods, services, or facilities between a plan and a disqualified person). Reorg. Plan No. 4 of 1978, § 102, 92 Stat. 3790. The Department of Labor's advisory opinions have consistently held since 1981 that the transfer of property in satisfaction of a funding obligation is a prohibited transaction. DOL Advisory Opinion 81-69A, *supra*; DOL Advisory Opinion 90-05A, *supra*. Accordingly, as that of the agency statutorily charged with interpreting Section 4975(c)(1)(A), the Department of Labor's consistent administrative position that a transfer of property in satisfaction of a funding

obligation is a prohibited sale or exchange is entitled to deference.[13]

Further, as we observed in our opening brief (at 31-32), it is instructive that the Internal Revenue Service has accorded the same meaning to the phrase "sale or exchange" in interpreting Section 4941 of the Internal Revenue Code, the provision upon which Section 4975 was modeled. See Rev. Rul. 81-40, 1981-1 C.B. 508; Rev. Rul. 77-379, 1977-2 C.B. 387. To be sure, as respondent notes (Br. 31-33), the Internal Revenue Manual currently states that if a plan permits contributions to be made in property, then the contribution of property "may" be a prohibited transaction, and previously stated that contributions of property were not prohibited. But the Internal Revenue Manual is not intended to be a statement of policy. The Manual only provides general guidance to audit agents, and it in no way either binds the IRS or carries the force of law. See *United States* v. *Will*, 671 F.2d 963, 967 (6th Cir. 1982) (Internal Revenue Manual "does not confer any rights upon the taxpayer"); cf. *Schweiker* v. *Hansen*, 450 U.S. 785, 789 (1981) (Social Security Administration's 13 volume Claims Manual has "no legal force"). Indeed, while basing its argument on the Manual, respondent ultimately

[13] Respondent's unsupported assertion that the Department of Labor's interpretation is not entitled to deference because its advisory opinions are binding only on the parties is without merit. Advisory opinions of the Department of Labor constitute official expressions of the Department's positions respecting ERISA and have been so treated by the courts. See, *e.g.*, *Massachusetts* v. *Morash*, 490 U.S. 107, 118 n.14 (1989); *Fraver* v. *North Carolina Farm Bureau Mutual Ins.*, 801 F.2d 675, 677-678 (4th Cir. 1986); *Shea* v. *Well Fargo Armored Service Corp.*, 810 F.2d 372, 376 (2d Cir. 1987); *MD Physicians & Associates, Inc.* v. *State Board of Ins.*, 957 F.2d 178, 186 n.9 (5th Cir.), cert. denied, 113 S.Ct. 179 (1992). Consequently, opinions expressed in such pronouncements fall within the rule that an agency's construction of a statute that it is charged with administering is entitled to considerable weight.

"acknowledges that the Internal Revenue Manual is not legally binding." Br. 33. Moreover, as noted, the Department of Labor, not the IRS, has primary responsibility for administering the prohibited transaction rules.

In any event, the administrative position of the Service is clear, as is evidenced by its position in this case and *Wood*. That position is consistent with the settled meaning of the phrase "sale or exchange" and the administrative position of the Department of Labor. The position of both agencies, as well as the PBGC, is that the transfer of property to a defined benefit plan in satisfaction of the transferor's funding obligations is a prohibited transaction under Section 4975(c)(1)(A).

For the foregoing reasons and those stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

WILLIAM C. BRYSON
Acting Solicitor General

JANUARY 1993

No. 91-1677

IN THE
Supreme Court of the United States

OCTOBER TERM, 1992

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,
v.
KEYSTONE CONSOLIDATED INDUSTRIES, INC.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF FOR THE PENSION BENEFIT GUARANTY CORPORATION AS AMICUS CURIAE SUPPORTING PETITIONER

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BRIEF FOR THE PENSION BENEFIT GUARANTY CORPORATION AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE PENSION BENEFIT GUARANTY CORPORATION

The Pension Benefit Guaranty Corporation ("PBGC") is the federal agency charged by Congress with administering and enforcing Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA"), including the pension plan termination insurance program. *See* 29 U.S.C. §§ 1301-1461.[1] PBGC guarantees retirement

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[1] Rule 37.5 of the Rules of this Court authorizes the filing of a brief *amicus curiae*, without the consent of the parties, "on behalf of any agency of the United States authorized by law to appear on its own behalf when submitted by the agency's authorized legal representative." The PBGC has such legal authority, pursuant to 29 U.S.C. § 1302(b)(1), and previously has filed *amicus* briefs. *See*,

benefits for more than 40 million Americans covered by defined benefit pension plans. *See generally Nachman Corp. v. PBGC*, 446 U.S. 359 (1980).[2]

PBGC's guarantees are triggered when a defined benefit plan terminates without enough assets to pay vested benefits. 29 U.S.C. § 1322. When an underfunded plan terminates, PBGC becomes trustee of the plan, *see* 29 U.S.C. § 1342(b)(1), (c), and pays to participants those basic benefits for which Congress has provided a guarantee, 29 U.S.C. §§ 1322, 1361; 29 C.F.R. pts. 2613, 2621. The money to pay for those guarantees comes from the premiums assessed against all sponsors of PBGC-insured pension plans. *See* 29 U.S.C. §§ 1306-1307. Despite large increases in the premium rates since PBGC was created in 1974, PBGC's deficit has been growing and now stands at $2.5 billion. 1991 PBGC Annual Report at 1. To keep PBGC's deficit from ballooning further and to ensure the continued viability of this government insurance program, PBGC is vigilant about possible pension abuses. *See, e.g., PBGC v. LTV Corp.*, 496 U.S. 633 (1990).

PBGC believes that the Fifth Circuit's decision in this case (Pet. App. 1a) invites serious pension-funding abuse. The Fifth Circuit ruled that the sponsor of a defined benefit pension plan did not engage in a "prohibited transaction" under section 4975 of the Internal Revenue Code when it contributed non-cash property to the plan in payment of its minimum funding obligation. The Fourth

e.g., Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California, 61 U.S.L.W. 3254 (1992); *Mead Corp. v. Tilley*, 490 U.S. 714, 716 (1989).

[2] Defined benefit plans provide retirees a fixed amount per month based on factors such as final salary and years of service. Such plans differ from defined contribution plans (also known as individual account plans), under which employers typically contribute a percentage of an employee's compensation to an account, and the employee is entitled to the account upon retirement. *See* 29 U.S.C. § 1002(34) and (35).

Circuit reached the opposite conclusion in *Wood v. Commissioner*, 955 F.2d 908 (4th Cir. 1992), Pet. App. 18a.[3]

Allowing non-cash contributions in satisfaction of a plan sponsor's statutory funding obligation creates a tremendous potential for abuse. The plan sponsor is generally the party valuing such non-cash contributions. And a plan sponsor, especially one experiencing financial difficulties, has an incentive to make non-cash contributions to conserve cash and to inflate the value placed on contributed property. In PBGC's experience, the value placed on non-cash property by the plan sponsor at the time of contribution often exceeds the value realized on the property after the pension plan terminates and PBGC becomes plan trustee.

Contribution of overvalued non-cash property by a plan sponsor is harmful in several ways. Not only are the required cash contributions not made, but, because participants continue to accrue benefits, PBGC's possible losses increase as the pension plan becomes more underfunded. Moreover, because the underfunding is concealed by the overvalued contribution, the statutory protections against underfunding (excise taxes, 26 U.S.C. § 4971, and funding suits, 29 U.S.C. § 1132(a)(5), (b)(1)) cannot be brought to bear and PBGC cannot make an informed decision about whether to terminate the plan.[4]

If in such a case the plan sponsor's business prospects do not improve, PBGC's potential losses become actual losses when the pension plan terminates. Moreover, be-

[3] Petitions for writs of certiorari were filed in both this case and *Wood*. This Court granted the petition in *Wood*, 112 S.Ct. 2937 (1992), but the petition was later dismissed, 112 S.Ct. 3061 (1992). Thereafter, the Court granted the Commissioner's petition in this case. 112 S.Ct. 2937 (1992).

[4] Section 1342(a) of Title 29 gives the PBGC authority to initiate plan termination where, *inter alia*, a plan has failed to meet the minimum funding standard or the agency's potential losses will increase unreasonably if the plan is not terminated.

cause the level of benefits guaranteed by PBGC is limited, *see* 29 U.S.C. § 1322; 29 C.F.R. pt. 2621, the participants and beneficiaries of the plan may suffer losses if the plan is underfunded due to a contribution of overvalued property.

Plan sponsors have generally complied with the Department of Labor advisory opinions that non-cash contributions are not permitted in satisfaction of pension funding obligations; accordingly, PBGC has not yet found a large number of cases where non-cash contributions were made. However, where such contributions have been made, the PBGC often has suffered substantial losses.

In one case, a financially troubled plan sponsor contributed to its pension plans shares of its own non-marketable stock, in lieu of cash, to satisfy a $26 million funding obligation. The plan sponsor valued the stock at $26 million. When the plan sponsor filed for bankruptcy shortly thereafter, it terminated its plans, which were underfunded by more than $550 million. And the stock that had been contributed was virtually worthless.

PBGC thereafter filed suit against the plan trustee who had accepted the stock at the inflated value, asserting, among other things, that the stock contribution was a prohibited transaction because it was not for "adequate consideration." *See* 26 U.S.C. § 4975(d)(13); 29 U.S.C. § 1108(e)(1). As successor trustee of the terminated pension plans, the agency sought to recover losses to the plans from this improper transaction. In pursuing the plan trustee, PBGC relied on the Department of Labor advisory opinions interpreting 29 U.S.C. § 1106, the ERISA parallel to 26 U.S.C. § 4975, to prohibit such non-cash contributions.

In the midst of settlement negotiations in that case, the Tax Court issued its opinion in *Wood*, Pet. App. 32a, *rev'd*, Pet. App. 18a. The opinion was used against the PBGC because it rejected the rationale of the Department

of Labor advisory opinions and held that non-cash minimum funding contributions were not prohibited transactions. PBGC subsequently settled the case for $5 million, which it believed at the time, and still believes, was a reasonable settlement; however, the settlement covered only a small portion of PBGC's total loss from this transaction. And as a result of the plans' underfunding at termination, participants lost $55 million to $60 million of benefits not guaranteed by PBGC.

In another recent termination, PBGC learned that the only contribution ever made to the pension plan of the now-bankrupt plan sponsor was a piece of real property. There were approximately $1.4 million in benefits due plan participants. Although the land was valued at $2 million by the plan sponsor at the time it was contributed to the plan in the early 1980's, it now has an estimated market value of only $350,000. While real estate market values have declined in the interim, it nonetheless appears that the original contribution was overvalued significantly. PBGC's funds must now be used to make up the plan's shortfall.

Finally, the facts of the *Wood* case provide a perfect example of the potential for abuse. The minimum funding obligation for the year in question was $114,000. Pet. App. 19a. Rather than co[illegible]te that amount in cash, the plan sponsor contributed [illegible]nissory notes with a face value of $114,000. *Id.* The market value of the notes, however, was only $94,430. Pet. App. 20a. Accordingly, the plan actually received $20,000 less than required by the minimum funding rules.

These examples illustrate how non-cash contributions to a defined benefit pension plan can harm the participants, the plan, and the PBGC. For the reasons explained below and in the Commissioner's brief, PBGC believes that Congress intended to prevent such abuses when it enacted the prohibited transaction provisions of ERISA and the Internal Revenue Code. We therefore

urge the Court to reverse the decision of the Fifth Circuit.

SUMMARY OF ARGUMENT

The Commissioner of Internal Revenue correctly determined that the non-cash property transfers to Keystone's pension plan were prohibited transactions. Section 4975 of the Internal Revenue Code prohibits insiders from engaging in "any direct or indirect . . . sale or exchange" of property with a pension plan or other benefit plan. 26 U.S.C. § 4975. This broad language unquestionably encompasses a transfer by a plan sponsor to satisfy its statutory funding obligation, for such a transfer is a direct exchange and the functional equivalent of a sale. The employer is causing the plan to exchange (or sell) its right to receive contributions for the property.

The Fifth Circuit held that the transfers in question were not prohibited transactions, however, because it construed section 4975(f)(3) of the Code as limiting the sale-or-exchange prohibition to transfers of *encumbered* property. The court erred. The Commissioner's interpretation does not render section 4975(f)(3) superfluous. That provision broadens the prohibited transaction rules to encompass voluntary contributions that would otherwise not be sales or exchanges. Not only is this the most natural reading of the statutory language, but it is confirmed by the legislative history. The House Conference Report shows that Congress adopted section 4975(f)(3) to prevent parties from circumventing the prohibition on sales or exchanges by mortgaging property and then giving it to a benefit plan. H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 306, *reprinted in* 1974 U.S. Code Cong. & Admin. News 5038, 5088.

The Fifth Circuit failed to follow the principles established by *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). The Department of Labor had addressed the precise issue presented here in a 1981 opinion letter, finding that transfers like

the ones in this case were prohibited transactions under the parallel ERISA provision, 29 U.S.C. § 1106. The Internal Revenue Service adopted a similar interpretation of the statutory provisions on which ERISA's prohibited transaction rules were based.

Those agency interpretations correctly discerned the congressional intent. But even if there were some ambiguity, the agencies' interpretation is a permissible construction of the statute because it is rational and comports with the statutory scheme. Congress enacted these *per se* prohibitions as preventive measures, to protect against possible abuse. It also set up an administrative procedure under which employers may make transfers such as the ones here, if they can show the Department of Labor that the transactions are in the best interest of the plan's participants and beneficiaries.

ARGUMENT

THE COMMISSIONER CORRECTLY DETERMINED THAT THE NON-CASH PROPERTY TRANSFERS TO THE PENSION PLAN WERE PROHIBITED TRANSACTIONS.

Keystone Consolidated Industries, Inc. ("Keystone") contributed to its defined benefit pension plan five truck terminals and some real estate in Key West, Florida, in purported satisfaction of its minimum funding obligations for the years 1982-84. Pet. App. 1a-2a. None of the property was subject to a mortgage or otherwise encumbered. *Id.* at 12a. The Commissioner of Internal Revenue determined that these transfers were "prohibited transactions" under section 4975 of the Internal Revenue Code, 26 U.S.C. § 4975. *Id.* at 3a.

Section 4975 imposes taxes on a number of prohibited transactions. The parallel provision in ERISA, section 406, states that a plan fiduciary "shall not cause the plan to engage in" those same prohibited transactions, absent

an exemption. 29 U.S.C. § 1106.[5] These *per se* prohibitions were enacted to protect pension plan participants and beneficiaries from transactions thought to be highly susceptible to abuse. *See Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629, 636-637 (W.D. Wis. 1979); *Leib v. Commissioner*, 88 T.C. 1474, 1481 (1987).

Here, the Commissioner asserted that Keystone's transfer of the truck terminals and the Key West property fell within section 4975(c)(1)(A) of the Code, which prohibits "any direct or indirect . . . sale or exchange . . . of any property between a plan and a disqualified person." 26 U.S.C. § 4975(c)(1)(A). It is undisputed that the pension plan is a "plan" and that Keystone is a "disqualified person" within the meaning of this provision. The only question is whether the transfer of the truck terminals and the Key West property was a "direct or indirect . . . sale or exchange."

The breadth of the statutory language powerfully suggests that it was. As the Commissioner explains (Brief at 15), the transactions were the functional equivalent of selling the property to the plan for cash and then contributing the cash to the plan in satisfaction of the statutory funding obligations. Thus, if not "direct" sales, the transactions clearly were at least "indirect" sales.

Alternatively, the transactions may be viewed as "direct . . . exchange[s]." Keystone exchanged the truck terminals and Key West property for satisfaction of its debts to the pension plan. Conversely, the pension plan exchanged its right to receive contributions (its receivables) for the non-cash property. Either way—as indi-

[5] The prohibited transaction rules in section 4975 of the Internal Revenue Code were added by Title II of ERISA. These provisions, with exceptions not relevant here, are interpreted by the Department of Labor. *See* Reorg. Plan No. 4 of 1978, 3 C.F.R. § 332 (1978), *reprinted in* 5 U.S.C. app. at 1374 (1988), *and in* 92 Stat. 3790 (1978). Title I of ERISA, administered by the Department of Labor, contains prohibited transaction rules that are substantially identical to those in Title II. *See* 29 U.S.C. §§ 406, 408.

rect sales or direct exchanges—the plain language of section 4975(c)(1)(A) encompasses and prohibits these transactions.

The Fifth Circuit did not deny this logic. The court, however, ruled against the Commissioner on the ground that section 4975(f)(3) of the Code limits the reach of section 4975(c)(1)(A) to transactions involving encumbered property. Section 4975(f)(3) provides:

> A transfer of real or personal property by a disqualified person to a plan *shall be treated as* a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

26 U.S.C. § 4975(f)(3) (emphasis added). The court of appeals reasoned that this provision would be superfluous if all transfers of property to a plan were deemed sales or exchanges. Pet. App. 5a. The court read the language of section 4975(f)(3) as "implying that unless it is encumbered by a mortgage or lien, a transfer of property is not to be treated as if it were a sale or exchange." *Id.*

The court of appeals erred in several ways. *First*, it is not true that section 4975(f)(3) would be superfluous under the Commissioner's interpretation of these provisions. The Commissioner's argument rests on the premise that the transfer is being made in satisfaction of an obligation. If there were no obligation and the transfer were purely voluntary, there would be no basis for prohibiting the transaction—in the absence of section 4975(f)(3)—because it would not be a "sale or exchange." Section 4975(f)(3), however, sweeps into the prohibited realm voluntary transfers of encumbered property, by directing that such transfers "shall be treated as a sale or exchange."[6]

[6] PBGC agrees with the Fifth Circuit that, in the case of defined benefit pension plans, it is questionable whether any contribution

Second, it is not true that the language of section 4975(f)(3) necessarily implies that unless the transferred property is encumbered it is not to be considered a sale or exchange. Rather, the statutory directive that transfers of encumbered property be "treated as" sales or exchanges suggests that Congress intended to proscribe such transfers even if they are *not* actually sales or exchanges—if, for example, the transfers are voluntary contributions. It implies nothing about transfers that are, within the ordinary meaning of the words, "direct or indirect . . . sale[s] or exchange[s]."

Third, and perhaps most importantly, the Fifth Circuit erred in disregarding the longstanding interpretation of these provisions by the agencies charged with their enforcement. The Department of Labor, which since 1978 has had primary authority to interpret the prohibited transaction provisions of both ERISA and the Internal Revenue Code,[7] articulated the rationale relied on here by the Commissioner in a 1981 advisory opinion:

> An employer assumes with respect to a defined benefit plan an obligation to make contributions to fund promised benefits. The contribution of the option [to purchase a condominium unit] by the Employer to the Plan constitutes a discharge by the Employer of its legal obligation to make the contribution for that year. *In effect, the Plan is exchanging its legal right to payment of that contribution for property other than cash. Accordingly, the contribution of the option*

can ever be considered "voluntary" because current contributions are credited against future funding obligations and do not, in the absence of a plan amendment, result in greater benefits for participants. *See* Pet. App. 6a. However, as the Commissioner points out (Brief at 13 n.9, 24-25), the prohibited transaction rules also apply to defined contribution pension plans and welfare benefit plans, none of which have statutory funding requirements. Voluntary contributions plainly are an issue for these plans. And in any event, there is no dispute that the contributions in this case were intended by Keystone to satisfy its funding obligations.

[7] See *supra* at 8 n.5.

> *by the Employer is a prohibited sale or exchange* of property between a plan and a party in interest under section 406(a)(1)(A) of ERISA.

Dep't of Lab. Advisory Op. 81-69A, 1981 ERISA LEXIS 24 (July 28, 1981) (emphasis added); *accord* Dep't of Lab. Advisory Op. 90-05A, 1990 ERISA LEXIS 5 (March 29, 1990).

Moreover, that same advisory opinion expressly rejected the argument adopted in this case by the Fifth Circuit—that section 406(c) of ERISA, the parallel to section 4975(f)(3) of the Code, "compels the conclusion that only encumbered contributions of real or personal property by an employer are prohibited by section 406(a)(1)(A)." Dep't of Lab. Advisory Op. 81-69A at 2, 1981 ERISA LEXIS 24. The Labor Department noted that this provision, modeled on tax laws regarding gifts of property to private foundations, prevents parties "from circumventing the section 406(a)(1)(A) prohibition on sales or exchanges by getting a loan on the property and donating it to a plan which must either pay off the loan or give up the property." *Id.* (citing H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 308, *reprinted in* 1974 U.S. Code Cong. & Admin. News 5038, 5088). The applicability of the rule "is limited to voluntary transfers," the Department concluded, and "no inference should be drawn from the rule that a contribution of property by an employer, in discharge of its legal obligation to contribute, would be permissible." *Id.*

The Internal Revenue Service has also adopted the same construction of section 4941 of the Code, the provision upon which section 4975 was modeled.[8] *See* Rev. Rul. 81-40, 1981-1 C.B. 508; Rev. Rul. 77-379, 1977-2 C.B. 387.

This Court has made very clear the analysis the Fifth Circuit should have undertaken in the face of these agency interpretations:

[8] Contrary to the Fifth Circuit's assertion (Pet. App. 8a), section 4941 contains a provision regarding encumbered property (section 4941(d)(2)(A)) that is almost identical to section 4975(f)(3).

> When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

Chevron, 467 U.S. at 842-843 (1984) (footnotes omitted) (*quoted in, e.g., PBGC v. LTV Corp.*, 496 U.S. at 647-648; *National Labor Relations Board v. Food and Commercial Workers*, 484 U.S. 112, 123 (1987)).[9]

Had the Fifth Circuit heeded *Chevron*, it could not have reached the conclusion it did. The most logical reading of the plain language of the statutory provisions is the one adopted by the agencies. Congress specified that even "indirect" sales or exchanges between a plan and a disqualified person were to be prohibited. In view of that broad language, and keeping in mind the overriding purpose of protecting benefit plans from transactions susceptible to abuse, it is almost inconceivable that Congress could have intended section 4975(f)(3) to limit the prohibition to transfers of encumbered property.[10]

[9] The Fifth Circuit's reasons for refusing deference to the agencies' interpretation do not withstand scrutiny. *See* Pet. App. 7a-8a. The court disregarded the Department of Labor's advisory opinion on the ground that it was "binding only on the parties thereto, and has no precedential effect." Pet. App. 8a. But this Court has made clear that deference principles apply to agency interpretations set forth in opinion letters. *See PBGC v. LTV Corp.*, 496 U.S. at 647-648 (PBGC opinion letters); *Mead Corp. v. Tilley*, 490 U.S. 714, 722 (1989) (same); *Massachusetts v. Morash*, 490 U.S. 107, 118 n.14 (1989) (Department of Labor opinion letter). IRS Revenue Rulings are similar to opinion letters and also are entitled to deference. *CenTRA, Inc. and Central Transport, Inc. v. U.S.*, 953 F.2d 1051 (6th Cir. 1992).

The legislative history confirms this interpretation. The Conference Report on ERISA noted that under the conference substitute, "the direct or indirect sale, exchange, or leasing of any property between the plan and a party-in-interest . . . is a prohibited transaction." H.R. Conf. Rep. No. 1280 at 307, 1974 U.S. Code Cong. & Admin. News at 5088. The Report then goes on to say:

> Under this rule, the transaction is prohibited whether or not the property involved is owned by the plan or party-in-interest, and the prohibited transaction includes sales, etc. from the party-in-interest to the plan, and also from the plan to the party-in-interest. *Also*, following the private foundation rules of the tax law, a transfer of property by a party-in-interest to a plan *is treated as a sale or exchange* if the property is subject to a mortgage or a similar lien . . . . *This rule prevents circumvention of the prohibition on sale by mortgaging the property before transfer to the plan.*

Id. at 307-08, 1974 U.S. Code Cong. & Admin. News at 5088 (footnote omitted) (emphasis added). The quoted language makes clear that section 4975(f)(3) was intended to plug a potential loophole in the broad prohibition on insider sales, not to narrowly define "sale or exchange."

Even if the lower courts felt there were some ambiguity, they were not free to "impose [their] own construction

[10] The Fifth Circuit's construction leads to the absurd conclusion that even a direct sale to a pension plan of property for cash would not be prohibited, so long as the property were unencumbered. The taxpayer in *Wood* acknowledged that this could not be. Pet. App. 23a (the taxpayer "readily agrees that if he had funded the plan with cash and then caused the plan to use the cash to purchase the third-party promissory notes from himself, the transaction would be prohibited by § 4975(c)").

on the statute." *Chevron*, 467 U.S. at 843. Rather, their role was to determine whether the Labor Department's and the Commissioner's interpretation was a " 'permissible' construction of the statute, that is, a construction that is 'rational and consistent with the statute.' " *PBGC v. LTV Corp.*, 496 U.S. at 650 (quoting *NLRB v. Food & Commercial Workers*, 484 U.S. at 123).

The agencies' interpretation easily passes that test. It is surely rational to say that transfers of property by an employer to a plan in satisfaction of an obligation fall within a prohibition on "direct or indirect . . . sale[s] or exchange[s]." It is also rational to conclude that another provision directing that transfers of encumbered property be "treated as" sales or exchanges should be read, not as *limiting* the broad prohibition to such transfers, but as *expanding* it to make sure that *all* transfers of encumbered property—even those that may be neither sales nor exchanges—are prohibited.

This interpretation is also consistent with the overall statutory scheme. As the Fourth Circuit noted in *Wood*, ERISA's prohibited transaction rules replaced an earlier "arm's length" standard of conduct, which " 'require[d] substantial enforcement efforts, resulting in sporadic and uncertain effectiveness of these provisions.' " Pet. App. 24a (quoting S. Rep. No. 383, 93d Cong., 1st Sess. 32, *reprinted in* 1974 U.S. Code Cong. & Admin. News 4890, 4917). ERISA imposed instead the *per se* rules found in section 4975 of the Code and section 406 of ERISA, which were intended to "substantially strengthen" the laws governing prohibited transactions. *Wood*, Pet. App. 24a. "The purpose of designating sales and exchanges of property between insiders and pension plans as prohibited transactions was to ensure pension plan integrity by eliminating even the possibility that such sales or exchanges might not be at arm's length." *Id.* at 24a-25a (citing *Donovan v. Cunningham*, 716 F.2d 1455, 1464-65 (5th Cir. 1983)). Interpreting these provisions to prevent only

transfers of encumbered property would be contrary to that broad remedial purpose.

The prohibition on sales or exchanges is, moreover, only one of a list of prohibited transactions between a plan and insiders. Section 4975 also prohibits insiders from engaging in any direct or indirect "lending of money or other extension of credit"; "furnishing of goods, services, or facilities"; or generally dealing with the plan or its assets for the benefit of the insider. To the extent it intended exceptions to this extremely broad list of prohibitions, Congress created certain specific "exemptions" in section 4975(d) of the Code and section 408 of ERISA. Only one of them involves the sale or exchange of unencumbered property, and that exemption is applicable only to a narrow and precisely-defined category of property. *See* 26 U.S.C. § 4975(d)(13), incorporating by reference provisions of ERISA § 408(e) relating to "qualifying employer securities" and "qualifying employer real property."

However, Congress directed the Department of Labor and the Internal Revenue Service to establish an exemption procedure under which exemptions may be granted from any of the restrictions in section 4975(c)(1). The Department of Labor may grant such an exemption if the exemption is (1) administratively feasible, (2) in the interests of the plan and its participants and beneficiaries, and (3) protective of the rights of participants and beneficiaries of the plan. 26 U.S.C. § 4975(c)(2); 29 U.S.C. § 1108(a). In administering these provisions, the Department of Labor seeks to ensure, among other protective conditions, that the transaction gives the Plan at least "adequate consideration." *See, e.g.*, 29 C.F.R. § 2570.34(b)(5)(iii) (exemption applications must contain appraisals or market analyses).

Thus, the agencies' position does not absolutely bar non-cash contributions to a defined benefit pension plan. An employer wishing to contribute property in satis-

faction of its funding obligation may do so if it obtains an administrative exemption. The exemption process assures that such contributions will occur only if they do not pose a danger to the plan, the participants, or the PBGC. PBGC believes that this is the result Congress intended when it enacted the prohibited transaction provisions.

CONCLUSION

For the reasons stated above and in the Commissioner's brief, the decision of the court of appeals should be reversed.

Respectfully submitted,

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